THE ONE-BANK HOLDING COMPANY

by

Bernon R. Erickson

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By

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CHAPTER I

INTRODUCTION

Economic progress is a function of the factors of production--manpower, materiel, and finance. In a free enterprise system, finance is the catalytic factor. Without it, the American economy would collapse. Banking is the most important aspect of the finance factor and therefore basic to the maintenance of a free and viable economy. Forces which effect changes in the structure of American banking may ultimately effect changes in the economic system.

Banking is a regulated industry. No development in recent years has stirred that industry and the rest of the financial community as has the emergence of the one-bank holding company. In common parlance, a one-bank holding company is simply a company that owns one bank. Its significance is that such a company is exempt from the regulatory jurisdiction of the federal government. They have become a powerful force in the American economy. It is important that we know more about them.

This research is directed toward a recognition of the forces behind the one-bank holding company development and of the relevant supervisory and legislative environment which made it possible. Its express purpose is to determine what,

if any, should be the direction and extent of future legislative action and/or changes in the interpretations of existing grants of power to the federal bank supervisory agencies in order to protect the public interest from a possible abuse of power by the managements of one-bank holding companies.

The assumptions on which this thesis is predicated are threefold: (1) The existence of one-bank holding companies as an integral part of the structure of American banking is not at issue, only the regulation thereof. (2) In a free enterprise economy, individuals and institutions act rationally to preserve their own, but often conflicting, self-interests; therefore, when the public interest is affected, a regulatory balance of opposing forces must be imposed. (3) Banking is not a stagnant activity; if it is to efficiently fulfill its role as the catalyst in the American economy, it must be responsive to changes in the economic environment.

The first assumption is founded on historical reality--one-bank holding companies have existed for over 100 years. The second is founded on the basic tenants of the mixed-enterprise philosophy of American government--a philosophy which encompasses a quasi-laissez-faire economy. The third is related to the second and is founded on the time proven law of supply and demand--if banking is not responsive to changes in the public's demand for financial services, that demand will be supplied by nonbanking institutions, and banking will lose its preeminence in the financial community.

Growth of One-Bank Holding Companies

Legal Basis

The Banking Act of 1933 prohibits banks from holding for their own accounts the stock of nonbank corporations.[1]

The Bank Holding Company Act of 1956 applied the same principle--the separation of the business of banking from other businesses--to holding companies holding 25 per cent or more of the stock of two or more commercial banks and that such companies must register with the Board of Governors of the Federal Reserve System.[2] Present banking legislation, therefore, exempts from federal regulation any holding company which controls only one bank.

Banks, which for various reasons desire to diversify their present activities into areas not previously deemed a proper banking function, by effecting a reorganization of their corporate structure, the culmination of which is the establishment of a one-bank holding company which holds 100 per cent of the shares of the bank, may presently engage in such activities without being subject to federal regulation or subjected to possible lawsuits by nonbank competitors.[3] The manner in which the reorganization is effected is popularly called the "phantom bank" method. The typical procedure involves several steps:

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[1] Banking Act (Glass-Steagall Act), Statutes at Large, XLVIII, ch. 89, sec. 16 (1933); U.S. Code, Vol. III, Title 12, sec. 27(7) (1964); see infra, pp. 31-36.

[2] Bank Holding Company Act, Statutes at Large, LIX, ch. 240, sec. 2(a) (1956); U.S. Code, Vol. III, Title 12, sec. 1841(a); see infra, pp. 36-39.

[3] See infra, pp. 58-60, 66-77.

Shareholders of the bank approve a reorganization first by means of incorporating a second holding company under general corporation laws.

The holding company applies to the appropriate supervisory authority for a charter to organize a new bank which is set up as a temporary shell or "phantom bank."

The existing bank is then merged into the phantom bank by the exchange of shares by the shareholders of the existing bank with that of the new holding company.

The necessity for this somewhat complicated procedure is predicated on the minimization of shareholder and tax problems.[1] Once established, the possibility for diversification by ancillary units is virtually unlimited.

Unprecedented Growth

A staff report of the House Committee on Banking and Currency dated February 11, 1969,[2] contains a statistical documentation of the growth of one-bank holding companies in recent years. The remainder of this section is devoted to a presentation of the significant findings of that report.

The Patman Report emphasized that the large increase in the number and size of one-bank holding companies is reflective of a "tremendous growth in a very short period of time."[3]

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[1]Hugh D. Galusha, "Banks, Agencies, Congress Should Define Scope of Financial Congenerics" (address before a meeting of the Ninth Federal Reserve District Bankers, Minneapolis, Minn., Dec. 1, 1968), published in American Banker (New York), Dec. 3, 1968, p. 4.

[2]U.S. Congress, House, Committee on Banking and Currency, The Growth of Unregistered Bank Holding Companies--Problems and Prospects, Staff report for the Committee on Banking and Currency, House of Representatives, 91st Cong., 1st sess., 1969. (Hereafter referred to as the "Patman Report.")

[3]Ibid., p. 10.

In 1955, there were 112 known one-bank holding companies with total commercial bank deposits of 11.6 billion dollars. In December 1965, there were 550 such companies, with total deposits of 15.4 billion dollars. In three years the number of one-bank holding companies had increased by almost 50 per cent, while total bank deposits had increased over 35 per cent. By December 31, 1968, the number of companies was 783 and deposits had grown to 108.2 billion dollars, when taking into consideration both existing and proposed one-bank holding company organizations. The growth in commercial bank deposits reflects an increase of over 800 per cent.[1]

The disproportionate increase in the asset base is explained by the fact that within the past eighteen months 34 of the 100 largest commercial banks in America with deposits of over 100 billion dollars have formed or stated intentions to form one-bank holding companies (see Table 1). Table 2 is a summary breakdown of existing and proposed one-bank holding companies as of December 31, 1968. It is significant that between September 1 and December 31, 1968, seven banks with deposits exceeding 14 billion dollars formed one-bank holding companies and seventy-six banks with deposits of nearly 72 billion dollars announced plans to adopt the one-bank holding company structure.

The figures compiled in Table 2 are detailed on a state-by-state basis in Table 3. This table further affords

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[1] *Ibid.*, pp. 1, 3. (The word "deposits" and words "bank deposits" hereafter connote "commercial bank deposits.")

TABLE 1

THE 34 OF 100 LARGEST COMMERCIAL BANKS IN THE UNITED STATES WHICH HAVE FORMED OR ANNOUNCED PLANS TO FORM ONE-BANK HOLDING COMPANIES AS OF DECEMBER 31, 1968

Rank as of June 30, 1968	Name of Bank, City, and State
1	Bank of America NT&SA, San Francisco, California
2	Chase Manhattan Bank NA, New York, New York[a]
3	First National City Bank, New York, New York
4	Manufacturers Hanover Trust Company, New York, New York
5	Morgan Guaranty Trust Company, New York, New York
6	Chemical Bank New York Trust Company, New York, New York
8	Continental Illinois NB&T Company, Chicago, Illinois
11	Wells Fargo Bank, San Francisco, California
12	Crocker-Citizens National Bank, San Francisco, California
21	First Penn. Banking and Trust Company, Philadelphia, Penn.
30	United States National Bank of Oregon, Portland, Oregon
31	Pittsburgh National Bank, Pittsburgh, Pennsylvania
32	National Bank of North America, Jamaica, New York
35	Union Bank, Los Angeles, California
37	Girard Trust Bank, Philadelphia, Pennsylvania
42	Wachovia Bank and Trust Company, Winston-Salem, N.C.
43	Fidelity Bank, Philadelphia, Pennsylvania
47	National Bank of Commerce, Seattle, Washington
50	North Carolina National Bank, Charlotte, North Carolina
54	Indiana National Bank, Indianapolis, Indiana
55	Maryland National Bank, Baltimore, Maryland
56	American Fletcher NB&T Co., Indianapolis, Indiana
57	Texas National Bank of Commerce, Houston, Texas
59	Hartford National Bank and Trust Company, Hartford, Conn.
64	Industrial National Bank of Rhode Island, Providence, R.I.
65	First Western Bank and Trust Co., Los Angeles, California
70	First Union National Bank of North Carolina, Charlotte, N.C.
71	Western Pennsylvania National Bank, Pittsburgh, Penn.
72	First National Bank, Atlanta, Georgia
79	American National Bank and Trust Company, Chicago, Illinois
80	First and Merchants National Bank, Richmond, Virginia
87	First National Bank, Memphis, Tennessee
89	Whitney National Bank, New Orleans, Louisiana
100	Union Commerce Bank, Cleveland, Ohio

[a]Chase Manhattan Bank announced plans to form a one-bank holding company on January 9, 1969.

Source: U.S. Congress, House, Committee on Banking and Currency, The Growth of Unregistered Bank Holding Companies--Problems and Prospects, Staff Report for the Committee on Banking and Currency, House of Representatives, 91st Cong., 1st sess., 1969, p. 6.

TABLE 2

NUMBER AND TOTAL BANK DEPOSITS OF ONE-BANK HOLDING COMPANIES EXISTING AND PROPOSED AS OF DECEMBER 31, 1968

Type of Status	Number	Deposits (in billions) as of June 30, 1968
One-bank holding companies formed as of September 1, 1968	684	$ 17.8
One-bank holding companies formed between September 1 and December 31, 1968 . . .	7	14.1
Banks announcing plans to form one-bank holding companies between September 1 and December 31, 1968	76	71.3
Nonbank institutions announcing plans to purchase banks between September 1 and December 31, 1968	16	4.5
Total	783	$108.2

Source: U.S. Congress, House, Committee on Banking and Currency, The Growth of Unregistered Bank Holding Companies--Problems and Prospects, Staff Report for the Committee on Banking and Currency, House of Representatives, 91st Cong., 1st sess., 1969, p. 7.

TABLE 3

NUMBER AND DEPOSITS OF REGISTERED AND UNREGISTERED BANK HOLDING COMPANIES
EXISTING AND PROPOSED AS OF DECEMBER 31, 1968, INCLUDING
PERCENTAGE OF TOTAL COMMERCIAL BANK DEPOSITS

State	Number of registered bank holding companies as of June 1968 (1)	Total deposits of registered bank holding companies as of June 1968 (millions of dollars) (2)	Unregistered bank holding companies existing as of Dec. 31, 1968 (3)	Total bank deposits[a] of unregistered bank holding companies existing as of Dec. 31, 1968 (millions of dollars) (4)	Proposed unregistered bank holding companies as of Dec.31, 1968 (5)	Total bank deposits[a] of proposed unregistered bank holding companies as of Dec.31, 1968 (millions of dollars) (6)	Total bank deposits in all bank holding companies (2 plus 4 plus 6) (millions of dollars) (7)	Percent of total commercial bank deposits in all existing and proposed bank holding companies (millions of dollars) (8)	Percent of total commercial bank deposits in existing and proposed nonregistered bank holding companies as of Dec.31, 1968 (9)	Total commercial bank deposits as of June 1968 (millions of dollars) (10)
Alabama	0	...	12	$ 78	1	$ 276	$ 354	9.1	9.1	$ 3,882
Alaska	0	...	1	31	..	0	31	8.1	8.1	384
Arizona	1	$ 872	3	345	..	0	1,217	47.0	13.3	2,592
Arkansas	0	...	10	92	2	222	314	13.6	13.6	2,302
California	6	4,025	15	2,465	8	24,548	31,038	75.1	65.4	41,327
Colorado	4	1,018	41	545	..	0	1,563	46.2	16.1	3,384
Connecticut	0	...	1	292	1	789	1,081	25.0	25.0	4,332
Delaware	0	...	4	165	..	0	165	15.0	15.0	1,102
District of Columbia	1	282	1	489	..	0	771	29.6	18.8	2,602
Florida	11	3,230	24	883	..	0	4,113	41.3	8.9	9,954
Georgia	4	1,995	8	176	1	688	2,859	49.7	15.4	5,755
Hawaii	0	...	..	0	1	85	85	6.7	6.7	1,263
Idaho	2	446	..	0	..	0	446	43.1	..	1,036
Illinois	2	382	72	2,242	9	6,257	8,881	30.7	29.4	28,911
Indiana	1	83	12	424	6	2,130	2,637	30.4	29.4	8,684
Iowa	3	480	67	870	..	0	1,350	25.7	16.6	5,256
Kansas	0	...	44	330	..	0	330	8.2	8.2	4,015
Kentucky	1	398	7	43	..	0	441	10.8	1.1	4,068
Louisiana	0	...	8	734	..	0	734	14.3	14.3	5,143
Maine	2	192	2	36	..	0	228	22.8	3.6	998
Maryland	1	124	1	10	1	824	958	22.7	19.8	4,212
Massachusetts	2	1,895	4	128	4	489	2,512	28.1	6.9	8,943
Michigan	1	203	3	38	..	0	241	1.4	.2	17,641
Minnesota	4	4,251	41	544	..	0	4,795	65.5	7.4	7,316
Mississippi	0	...	..	0	2	618	618	25.2	25.2	2,452
Missouri	3	393	42	648	6	1,096	2,137	22.2	18.1	9,610
Montana	4	667	15	85	..	0	752	60.0	6.8	1,253
Nebraska	1	271	47	193	3	579	1,043	38.3	28.3	2.724
Nevada	1	522	1	93	..	0	615	70.9	10.7	868
New Hampshire	1	128	3	46	..	0	174	23.8	6.3	730
New Jersey	0	...	4	123	5	1,012	1,135	9.4	9.4	12,072
New Mexico	1	162	5	41	1	185	388	35.2	20.5	1,103
New York[b]	12	14,529	14	14,117	6	20,182	48,828	64.2	45.1	76,099
North Carolina	0	...	2	20	5	2,949	2,969	54.6	54.6	5,437
North Dakota	3	480	4	16	..	...	496	44.0	1.4	1,128
Ohio	3	2,226	26	1,213	2	144	3,583	19.4	7.3	18,470
Oklahoma	0	...	19	553	3	747	1,300	29.8	29.8	4,356
Oregon	1	1,430	1	4	2	1,419	2,853	85.3	42.6	3,343
Pennsylvania	0	...	3	40	9	6,879	6,919	29.1	29.1	23,745
Rhode Island	0	...	9	850	..	0	850	59.9	59.9	1,420
South Carolina	0	...	4	22	4	721	743	42.4	42.4	1,752
South Dakota	2	462	21	105	..	0	567	47.0	8.7	1,206
Tennessee	3	203	7	131	3	1,476	1,810	31.7	28.1	5,717
Texas	3	1,118	46	818	4	1,081	3,017	14.8	9.3	20,452
Utah	2	745	5	243	..	0	988	64.4	15.9	1,533
Vermont	0	...	1	22	..	0	22	3.2	3.2	688
Virginia	5	2,300	1	4	3	891	3,195	51.2	14.4	6,234
Washington	3	652	2	951	..	0	1,603	34.3	20.4	4,667
West Virginia	0	...	6	106	..	0	106	4.8	4.8	2,208
Wisconsin	10	2,597	15	347	..	0	2,944	37.9	4.5	7,773
Wyoming	2	102	7	112	..	0	214	35.0	18.3	612
Total	106	$ 48,863	691	$ 31,863	92	$ 76,287	$ 157,013	40.0	27.5	$ 392,754

[a]Bank deposits as of June 1968.

[b]Since compilation of these statistics as of Dec. 31, 1968, Chase Manhattan Bank, the Nation's second largest commercial bank, has announced plans to form a 1-bank holding company. This raises the New York State figure to 21 1-bank holding companies with $47,000,000,000 in commercial bank deposits. This addition increases the portion of all commercial bank deposits in New York State held in 1-bank holding companies to 62 percent.

Source: U.S. Congress, House, Committee on Banking and Currency, The Growth of Unregistered Bank Holding Companies--Problems and Prospects. Staff Report for the Committee on Banking and Currency, House of Representatives, 91st Cong., 1st sess., 1969, pp. 7-8.

a comparison of bank deposits held in existing and proposed one-bank holding companies to the deposits held by registered bank holding companies. The information contained therein is enlightening:

> One-bank holding companies have twice as many bank deposits as do the registered bank holding companies, a complete reversal of the pre-1965 era.
>
> Deposits of all bank holding companies amount to 40 per cent of the total deposits in the nation. Of this amount, 57.9 per cent are located in existing or proposed one-bank holding companies.
>
> The major banking states are in the vanguard of the movement. Existing or proposed holding companies hold more than 69 per cent of deposits in California, 52 per cent in New York. The deposit base in California is 37 billion dollars and in New York the figure is 47 billion dollars. In contrast, registered bank holding companies in California number 15 with deposits of 4 billion dollars, while in New York the figures are 14 companies and 14.5 billion dollars in deposits.
>
> The smaller states have not been unaffected. In North Carolina, seven existing or proposed one-bank holding companies account for over 54 per cent of bank deposits. In Rhode Island, the figures are nine companies and 58.9 per cent of deposits.

Many other examples in both large and small banking centers can be found in Table 3 (page 8).

The Patman Report provided statistical data concerning the nonbanking activities of the one-bank holding company organizations. It reported that as of September 1, 1968, 578 of the known one-bank holding companies participated in twenty different financial nonbanking activities and 397 participated in ninety-nine different nonfinancial activities. The financial activities included insurance and various types of credit institutions, while the nonfinancial activities

ranged throughout the entire spectrum of commercial enterprise.[1]

Taken in and by themselves these nonbanking activities statistics are impressive. The vast majority, however, are representative of the activities of the many small and traditional one-bank holding companies in-being prior to the existing and accelerating growth pattern.[2] Table 2 (page 7) clearly shows that the deposit base of one-bank holding companies on September 1, 1968, was less than 20 per cent of the deposit base of existing and proposed one-bank holding companies as of December 31, 1968, just four months later.

The Research Question

The research question of this thesis is: Should the one-bank holding company corporate structure be brought under the regulatory jurisdiction of the federal government? A meaningful determination is dependent upon the answers to several subsidiary questions, some of which are interrelated. These are:

> What are the characteristics of the American banking system and what economic constraints have governmental laws imposed on the industry?

> What are the causative factors behind the growth of the one-bank holding company form of enterprise?

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[1] *Ibid.*, pp. [illegible].

[2] See *Ibid.*, Table 11, "Principal Financial and Non-financial Activities of Known One-Bank Holding Companies and Their Subsidiaries as of September 1, 1968, in Alphabetical Order by State," pp. 52-59, for identification of these banks.

Can proper banking activities be rigidly defined in a swiftly changing economic and technological environment?

Does the one-bank holding development make it more difficult for the federal supervisory authorities to protect the public against the consequences of bank failures?

Should there be a differentiation in the regulatory treatment between a conglomerate-dominated one-bank holding company, a bank-dominated one-bank holding company, and a multi-bank holding company?

Can the application of the antitrust laws be used to inhibit the unrestrained formation of conglomerates of all kinds in order to prevent the excessive buildup of economic or financial power?

Research Methodology

The essence of this thesis is an inquiry into federal regulation over the nonbank activities of the banking industry. The majority of the information and data were gathered from secondary sources. These included: congressional committee hearings and reports, the U.S. Code, the Statutes at Large, judicial decisions, publications, and memorandums prepared by government and private organizations.

Because of the immediacy of the one-bank holding company development, this work could not have been accomplished within the imposed timetable if it had not been for the writer's physical presence in the Nation's capital. The collection, compilation and analysis of data were immeasurably aided by the expertise available from both government and private sources in the Washington, D.C., area. Officials in the Nixon Administration, the federal bank supervisory agencies, members and staff of the Senate and House Banking and Currency Committees, and officers of private interest groups

were interviewed. Although all are not credited in the bibliography, the writer is indebted for their assistance in locating and analyzing the data so necessary to the completion of this work.

Organization of the Thesis

Chapter Two is an overview of the structure and control of the American banking system. It provides the historical perspective for consideration of the one-bank holding development.

The third chapter discusses the debate over the proper business of banking. It is concerned with the factors leading to the organization of financial congenerics,[1] the interpenetration of the financial markets, and the legal controversy centered around the question of what is the business of banking.

"The One-Bank Holding Company and the Public Interest," the fourth chapter, is concerned with the question of whether or not existing legislation is adequate to protect the public from possible abuses of power by the operators of one-bank holding companies. Attention is focused on the issues of bank solvency and concentration of economic power.

Chapter Five is devoted to an analysis of legislative proposals offered by the Administration and members of Congress for the purpose of bringing one-bank holding companies under the regulatory umbrella of the federal government. The viewpoints of the federal bank supervisory agencies and of private interest groups will also be presented.

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[1]See *infra*, p. 48 for definition.

In the concluding chapter, the writer summarises his findings and presents his conclusions as to what should be the direction and extent of future legislative action in order to serve best the public interests affected by the one-bank holding company development.

It is important to inform the reader of what this thesis is not about. In the next chapter it is seen that banks operate in a dual system--there are both state and nationally chartered banks.[1] Each state has its own banking laws, some of which are addressed to the problem of control over bank holding companies. The area of this study is one-bank holding companies and the federal regulation thereof. The limited time available for the completion of this work precluded the extension of the area of study beyond the national level. Moreover, because of the interface of banking activities between the states and because most banks are insured by the Federal Deposit Insurance Corporation and thereby subject to federal regulatory controls, a resolution of the problem at the national level virtually encompasses its resolution at the state level.

This study is not primarily addressed to an analysis of the structure of the American banking system; for example, it is not concerned with chain banking, branch banking, bank mergers, and interlocking directorates among banks and other institutions. Nor is it specifically addressed to the identification of the numerous control and audit procedures employed

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[1]See infra, pp. 16-20.

by federal supervisory authorities to ensure that banks are operating in compliance with existing regulations. At times, these issues may be discussed but only in relation to the main issue under study--the one-bank holding company.

CHAPTER II

AN OVERVIEW OF THE STRUCTURE AND CONTROL OF THE AMERICAN BANKING SYSTEM

The serious student of any problem cannot fully understand the present unless he is aware of the contributions of the past. An historical overview of the structure and control of the banking system in America is therefore justified as a means of illuminating problems in banking brought about by the accelerating growth of one-bank holding companies. Accordingly, it will be helpful to sketch briefly some of the outstanding events and developments in our banking system.

Purpose of Banking Legislation

The regulation of banking is traditional; in fact, banking has been subject to regulation for a longer period than any other American industry. It is both comprehensive and intimate.[1]

Historically, the primary purpose of banking legislation in authorizing the regulation of banking has been the protection of the public interest by securing the safety and soundness of banks and by promoting competition. Implicit in this purpose is the triple objective of liquidity, solvency,

[1]Emmette S. Redford, American Government and the Economy (New York: The Macmillan Company, 1965), p. 527.

and honest practice. A bank must have adequate liquidity to be able to respond to the currency demands of depositors and to meet drains of funds when checks are deposited with other banks. Bank solvency affects the economic interests of depositors, stockholders and the community. Fair banking practices are stressed in the regulatory process because the ability of the banking system to create money can result in opportunities for unfair advantage or shady practices by insiders.[1] Lastly, since the passage of the Employment Act of 1946,[2] stabilization and growth of the economy has been a national objective. The maintenance of a banking system that will continuously and responsively adapt to the financial needs of a growing economy and in which individual units will compete actively in rendering banking services aids in the achievement of this objective.

Dual Banking Structure

The banking system today is "a dual and essentially a unit bank system which has its roots deep in American democratic tradition."[3] The significant characteristic of the system is that it is one in which there are both state and national banks. Banking is the only regulated industry where

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[1] Paul B. Trescott, Money, Banking, and Economic Welfare (2d ed.; New York: McGraw-Hill, Inc., 1965), p. 510.

[2] Employment Act, Statutes at Large, LX, ch. 32 (1946); U.S. Code, Vol. III, Title 15, secs. 1021-24 (1964).

[3] Ralph W. Lamb, Group Banking (New Brunswick, N.J.: Rutgers University Press, 1962), p. 4.

individual companies are allowed to choose the regulatory jurisdiction of either the state or national agencies.

The commercial banks comprising this dual system may be classified by type of charter, by membership in the Federal Reserve System, and by whether they are single or multiple office banks. Both the United States Treasury and the individual states grant bank charters and the banks operating under these charters are respectively referred to as "national" banks or "state" banks. Table 4 sets forth the numerical relationships of state and national banks and the total money output of each type. There are almost twice as many state banks as national banks, but the national banks account for nearly two-thirds of all bank assets.

Membership in the Federal Reserve System is compulsory only for federally chartered banks. Table 5 depicts bank membership and the money output for the various classes of banks. Although less than one-half of all banks are members, it is clear that the predominant portion of the money output (approximately 85 per cent) of the commercial banks is produced by members of the Federal Reserve System.

Commercial banks may be further differentiated into unit banks and branch banks. A unit bank operates only one banking office, and a branch bank offers complete banking services at more than one office. The unit bank has been the backbone of the banking industry. This is reflective of the nineteenth century pattern of "numerous, relatively small, relatively localized banks . . . [preferred by] both bankers

TABLE 4

STRUCTURE OF COMMERCIAL BANKS, JANUARY 1, 1967

Type of Charter	No. of Banks	No. of Branches	No. of Offices	Money Output (millions of dollars)	Percentage of Total Money Output
National	4,799	9,611	14,410	$105,991	57.5%
State	8,968	7,297	16,265	78,289	42.5
Total	13,767	16,908	30,675	$184,280	100.0%

Source: Federal Reserve Bulletin, June, 1967, p. 996.

TABLE 5

MEMBERSHIP IN THE FEDERAL RESERVE SYSTEM, JANUARY 1, 1967

	No. of Banks	Percentage of Total	Money Output (millions of dollars)	Percentage of Total Money Output
Member banks:				
National	4,799	34.9%	$105,991	57.5%
State	1,351	9.8	46,724	25.4
Nonmember banks:				
National	. . .	. . .	. . .	. . .
State	7,617	55.3	31,565	17.1
Total	13,767	100.0%	$184,280	100.0%

Source: Federal Reserve Bulletin, June, 1967, p. 996.

and regulatory agencies . . . [since] there were no particular advantages in large scale bank operations or in branching, and the state of transport and communication made branch management difficult."[1] Also, the emphasis on "states rights" has contributed greatly to the growth of unit banking. Even the national banks are not "national" in the sense that there is not one bank that operates a nation-wide branch system.[2]

The branching powers of national banks are subject to the statutes of the fifty states, which range from strict prohibition to state-wide operation. A national bank seeking to branch must obtain the approval of the Comptroller of the Currency, and state banks require the consent of the state banking authority, and those that are members of the Federal Reserve System must also obtain approval of the Federal Reserve Board. However, a nonmember insured bank requires the approval of the Federal Deposit Insurance Corporation.

The dual chartering and regulation of banks is perhaps the most significant element in the legal framework of the relationships between government and banking. It is directly opposite to that espoused by England and other European countries. These nations employ a nation-wide system of a few great branch banks centered on a single pivot like the Bank of England.[3]

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[1] Prescott, Money, Banking, and Economic Welfare, pp. 319-20.

[2] Ibid., p. 321.

[3] Richard S. Sayers, American Banking System: A Sketch (London: Oxford University Press, 1948), p. 1.

A review of the history of banking legislation and control in the context of the dual banking system can now be recorded. The writer chooses to examine this history by dividing it into four periods: Colonial and Constitutional; Free Banking; National Banking; and Federal Reserve System.

Colonial and Constitutional Period

The European immigrants to the New World were familiar with the three basic types of money: commodity, fiat, and bank money. However, the primitive economy of the colonies was not sufficient to exclusively support a commodity money system and the political climate was not conducive to the replacement of commodity money with fiat or bank money.

As the productive efficiency of the economy increased and the political process developed, the application of the specialization of labor became advantageous and the employment of fiat money and bank money became progressively more available as supplementary to the numerous types of coin produced by the European governments, the mainstay of the colonial monetary system.

Fifteen years after the adoption of the Constitution the "First Bank of the United States" was chartered by the Federal government, the purpose of which was to give the United States an independent fiscal agent. A main office was established in Philadelphia and eight branches were located in the leading cities of the nation. They operated on a large scale in both private and governmental areas. Unlike central banks in other countries whose operations are limited to

serving only commercial banks, the First Bank served the public directly.

The currency issued by the First Bank was not legal tender, but was made eligible for the payment of federal taxes. The guarantee of acceptance by the central government gave it an advantage over the notes of other banking institutions.

The Bank's twenty-year charter was not renewed. The main reasons for allowing the charter to lapse were the political opposition of those who feared the growth and extension of power by the central government and the fact that over two-thirds of the bank's assets were owned by British capitalists. The latter reason is indicative of the strained relations this country had with England during this period. Thus, the nation was left with the unreliable state-chartered banks to support the War of 1812.[1]

From 1811 to 1815, the number of state banks increased from 88 to 208, and their notes increased from $23,000,000 to $110,000,000.[2] By 1814, the expansion in the supply of paper money relative to the amount of gold or silver coin available rendered most of the banks outside New England unable to redeem their notes in specie. This situation caused the central government constant embarrassment, since it was unable to transfer funds in the form of bank deposits to meet varying

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[1]Rollin G. Thomas, Our Modern Banking and Monetary System (2d ed.; New York: Prentice-Hall, Inc., 1950), p. 249.

[2]Ibid.

needs. The public associated the currency crisis with the disestablishment of the First Bank of the United States.[1]

The economic and political climate was favorable for the erection of a new federally-chartered bank, the result of which was the authorization of the "Second Bank of the United States." The provisions for its charter were generally the same as that of the First Bank; however, like the First Bank, it was saddled with the congenital infirmity of a limited charter (twenty years). After a somewhat shaky first two years the bank performed fairly well and at one time had as many as twenty-five branches. However, it was unable to maintain the currency at par, a situation which added "fuel to the fires" of the advocates for States' rights. Accordingly, the extension of the charter became a major campaign issue in 1832 between Henry Clay and Andrew Jackson. Jackson won re-election, and the Bank of the United States was destined for extinction. It discontinued operation as a federal institution in 1836; however, its offices remained in existence as state-chartered banks.

The experiences with the Bank of the United States provoked the beginning of a geographic branching trend of banking. "In sharp contrast to the situation in later periods, large-scale banking occupied a relatively important position in the early years of banking in this country."[2]

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[1]A. Barton Hepburn, A History of Currency in the United States (New York: The Macmillan Company, 1924), p. 90.

[2]Lamb, Group Banking, p. 15.

Free Banking Period

From 1836 to well into the Civil War, the state of commercial banking in the United States can be termed chaotic. With the passing of the Second Bank, the participation of the federal government in the banking industry came to an abrupt halt. The banking system that replaced it became known as "free banking," which "was the term applied to a system under which charters were granted under general law to all associations which met legal requirements. The result was more than a triple increase in the number of state banks in the approximately twenty-five years prior to the Civil War."[1] Almost anyone who was able to meet a standard list of legal requirements was permitted to open a bank, and, although many banks were operated in accordance with sound business practices, the period was occasion for many corrupt practices. The flavor of the period is well captured in the following quotation:

> Between 1836 and 1863 . . . eleven new states joined the union and the frontier was wide open. With each . . . came new banks. What had been free banking in . . . the middle Atlantic states, became "wildcat banking" in the new frontier territory. These new banks, which were either uncapitalized or undercapitalized, began to issue notes as currency. They immediately became known as "wildcat" banks because it was said that one had to go to places where there was nothing but wildcats in order to redeem the notes and some of these banks were purposely placed in remote locations in order to make it impossible to redeem their notes. It was a real con game. "Banks" had armed guards posted at intervals surrounding the approaches to the bank in its remote location. If anyone did manage to find their way there in order to

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[1]Redford, American Government and the Economy, p. 528.

attempt to redeem a note, the armed guards prevented their entry to the premises.[1]

The panic of 1857 resulted from these and other more minor abuses of the public interest by the banking industry. Only the banks located in Louisiana were able to survive without suspending operations.

> . . . Louisiana had adopted legislation which was in diametric opposition to the free banking legislation. It required that cash reserves be maintained equal to a third of the combined note and deposit liabilities and liquid assets equal to the other two thirds . . . the banks in the state of Louisiana in maintaining their operations . . . was a sober and enlightening experience for the bankers in the large cities to the north. It had a significant influence upon their operations in the future and upon all the legislation which was subsequently adopted in every state in the union.[2]

National Banking Period

The problem of financing the Civil War was one of President Lincoln's greatest problems. The banking system was too weak to assist the government materially in this effort. Inflation had increased domestic prices relative to those of other gold standard countries so that gold became more valuable abroad. Accordingly, banks were priced out of the gold market and were unable to redeem their notes in specie. To finance the war, the United States Treasury was authorized by Congress to issue paper money. Initially the currency was redeemable in gold, but in 1862 the Treasury--just as the banks--declared itself unable to do so. The notes were printed on green paper

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[1]Warren W. Koffler, "A Banking Primer," *Mergers & Acquisitions: The Journal of Corporate Venture*, III (September-October, 1968), 23.

[2]*Ibid.*, p. 24.

and became known as "greenbacks," indicating they were not worth any more than the color of the paper upon which they were printed. The nation's economy had shifted from a commodity money monetary system to one based on fiat money and bank money.

The increasing economic demands of the war rendered imperative that "the disadvantages of an uncertain money be avoided as much as possible."[1] Major reform to the banking system was again necessary. This reform was accomplished by the passage of the National Currency Act of 1863,[2] and it constituted the legal beginning of a national banking system.

The title is explanatory of the purpose of the act: "An Act: to provide a national currency, secured by a pledge of United States stocks, and to provide for the circulation and redemption thereof." It provided for the establishment of national banks, which were permitted to issue bank notes in the amount equivalent to the value of government bonds which they held and placed the administration of the system in the newly created office of the Comptroller of the Currency.

The new legislation did not liquidate the states' powers to charter and control banks. A dual banking structure was to emerge again.

A major barrier to entry into the national system was the reluctance of state-chartered banks to accept the

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[1]Thomas, Modern Banking and Monetary System, p. 256.

[2]National Currency Act, Statutes at Large, XII, ch. 58 (1863).

uncertainties of national supervision. "Rewritten and liberalized, the National Bank Act of 1864 exerted no magnetic attraction, either to existing banks or to new capital."[1] Their reluctance dissipated when Congress in 1865 levied a 10 per cent tax on the circulation of bank notes. State banks converted in large numbers. Generally, it was the larger banks, who were heavily committed to deposits as opposed to note issue, that elected to retain their state affiliation.

Under the act, the principal function of the Comptroller of the Currency is to supervise and examine the creation of banks. It set forth specific and demanding capitalization requirements for banks desiring entry into the national system and provided for the maintenance of express cash and reserve deposits. Provisions for detailed supervision soon resulted in the eradication of many of the practices which had impaired the solvency of banks in the prewar period.

It seemed as if the banking problems of the country had been solved, but, as time passed, weaknesses in the system surfaced. The higher interest rates paid by New York City banks resulted in excessive bank reserve deposits in their accounts. Since banks were frequently "loaned out" and no facilities were available to provide additional funds, tight money was the norm. The inelasticity in the supply of

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[1]U.S., Comptroller of the Currency, "The Comptroller of the Currency in Historical Perspective," Annual Report, 1965 (Washington, D.C.: Government Printing Office, 1966), p. 1.

currency rendered the monetary system incapable of responding adequately to meet seasonal demands.

These weaknesses were largely responsible for the Wall Street Panic of 1907, which provided the spark for a congressional creation of a National Monetary Commission to investigate the entire spectrum of the banking industry. The results of the Commission's investigation led to a major reconstruction of the banking system through the creation of the Federal Reserve System in 1913.[1] America's monetary system entered a new era.

Federal Reserve Period

On December 23, 1913, the Federal Reserve Act[2] establishing the Federal Reserve System was signed by President Wilson. Its original purposes were to provide for an elastic currency, facilities for discounting commercial paper, and improved supervision of banking. From the outset, there was recognition that these purposes were parts of broader objectives which over the years have been identified as the maintenance of a high level of employment, a stable price level, a growing economy, and a sound balance of payments.[3]

The original legislation provided for the creation of what has become known as the Board of Governors of the Federal

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[1] Redford, American Government and the Economy, p. 157.

[2] Federal Reserve Act, Statutes at Large, XXXVIII, ch. 6 (1913), U.S. Code, Vol. III, Title 12, sec. 226 (1964).

[3] E. U. Hatchford and Robert P. Black, The Federal Reserve at Work (3d ed.; Washington, D.C.: Government Printing Office, 1967), p. 5.

Reserve System and the twelve Federal Reserve Banks across the nation. They comprise what is essentially a central bank for the United States. A central bank is a bankers' bank. It does not directly serve the public, but supervises those that do. It controls the volume of bank credits and of the nation's money supply.

The National Monetary Commission had recommended the creation of a single central bank, but the fear that the new system would be dominated by a few powerful interests caused Congress to set up a regional system of independent Reserve Banks. The Reserve Banks are owned by the national banks in each of twelve regions or districts; that is, each bank owns stock in the Federal Reserve Bank of which it is a member. Fundamentally, membership in the system is voluntary. The membership of national banks is required, but a reluctant bank can always shift to a state charter.[1] To establish another link between the Board and the banking community, the Act provides for a Federal Advisory Council consisting of one member from each district. The council's main function is to advise the Board. It exercises no powers of its own.

Changes in the organizational structure of the Federal Reserve System were incorporated in the National Banking Act of 1935.[2] The Federal Reserve Board was renamed the "Board of

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[1]Trescott, Money, Banking, and Economic Welfare, p. 447.

[2]Banking Act, Statutes at Large, XLIX, ch. 614 (1935), U.S. Code, Vol. III, Title 12, sec. 228 (1964).

Governors" and made the policy-making head of a central bank, and the twelve separate banks were converted into branches of the central bank. The provision for ex officio membership of the Secretary of the Treasury and the Comptroller of the Currency, as provided in the original act, was not retained in the new legislation. Additionally, an open-market committee, which emerged in 1922 to represent the Reserve Banks and co-ordinate their open-market activities was reconstructed and granted power to require bank compliance with the operational orders of the committee.

In summary, the organization essentially consists of (1) the Board of Governors, (2) the Federal Open Market Committee, (3) the Federal Advisory Council, (4) the Federal Reserve Banks, and (5) the member banks. It is not within the purpose and scope of this paper to present the detailed structural organization of the Federal Reserve System, nor to discuss the operating methods by which the System seeks to achieve inherent objectives. In passing, however, it should be noted that the Federal Open Market Committee is "the system's most important policy-making body."[1] It is composed of the seven members of the Board plus the president of the New York Federal Reserve Bank and four other Reserve Bank presidents. The Committee exercises absolute control of the open-market operations of the Reserve Banks. By its control over the extent to which the System buys and sells securities, the

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[1] Ratchford and Black, The Federal Reserve at Work, p. 8.

Committee provides the dominant influence on the domestic money supply.

Following World War I, this country entered a period of high production and rapid industrial expansion. A runaway boom was underway. The availability of easy credit through the Federal Reserve System led banks to make low interest loans to their customers, who in turn speculated in the market. An ever-increasing inflationary spiral developed. Between September, 1927, and September, 1929, borrowings for speculation on the New York Stock Exchange rose from three and one-third to eight and one-half billion dollars.[1]

The collapse came on October 29, 1929, when the immense selling pressure on stocks reached 16,410,030 shares. In spite of repeated assurances from authorities, both in government and finance, that prosperity lay "just around the corner," no less than nine similar declines to "new low levels" were recorded within the next three years. By March 1, 1933, the value of all stocks listed on the New York Exchange was less than one-fifth the inflated figures of October 1, 1929.[2] The following quotation is reflective of the effect of easy credit on the banking community during the "roaring twenties."

> . . . Beginning in 1921, the number of commercial banks decreased by several hundred each year, 5,411 falling

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[1] John D. Hicks and George E. Mowry, A Short History of American Democracy (2d ed.; Boston: Houghton Mifflin Company, 1956), p. 722.

[2] Ibid.

> over the 9-year span of 1921-29. From 1930 to 1933, 8,812 . . . banks suspended, nearly half of them going under in 1933 alone. Of the 14,000 banks suspending between 1921 and 1933, 11,300 were State banks and 2,700 were National banks. More than 90 per cent . . . were in communities with less than 25,000 inhabitants, and 85 per cent of the suspending banks had total assets of less than $1 million.[1]

Shortly before the inauguration of President Roosevelt, the public responded to the epidemic of bank failures by a mass "run on the banks." On March 6, 1933, Roosevelt, in order to allow the situation to settle down, closed all banks in the United States.[2] Three days later, Congress passed the Emergency Banking Act[3] providing for orderly reopening of the banking facilities. This action marked the beginning of a change in federal policy directed toward the banking industry, with particular emphasis to be placed on the protection of depositors and the regulation of interbank control. A "New Deal" was in the making, and the banking and monetary reforms subsequently dealt were to place the federal government more firmly in the "seat of control" of the dual banking system.

Banking Act of 1933

The New Deal's legislative package for the banking industry was primarily contained in the Banking Act of 1933 and the Banking Act of 1935. The 1935 legislation was primarily concerned with the modernization of the Federal Reserve

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[1]U.S., Comptroller of the Currency, "Currency in Historical Perspective," p. 5.

[2]Redford, American Government and the Economy, p. 168.

[3]Emergency Banking Relief Act, Statutes at Large, XLVIII, ch. 1 (1933).

System, the significant features of which were presented earlier in this chapter. These acts were the result of extensive congressional hearings concerning the future role of the federal government in the supervision and control of the banking industry from 1931 through the first part of 1933. The principal objective of Congress, in passing this legislation, was to provide for the federal supervision of reserve, dividend and related financial policies in order to protect depositors.[1] The 1933 Act prohibited banks from holding for their own accounts the stock of nonbank corporations and authorized the establishment of the Federal Deposit Insurance Corporation as the government's primary instrument in securing the protection of depositors and further aided that protection by divorcing commercial from investment banking.[2] The latter action was taken to separate banks from the risks of the securities business.

The sole function of the Federal Deposit Insurance Corporation is to guarantee bank deposits.[3] "The salutary effect of this guarantee on the economic life of the country as a whole from abolishing runs on banks can hardly be denied."[4] When established, the agency had authority to

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[1]George R. Hall, "Bank Holding Company Regulation," Southern Economic Journal, XXXI (April, 1965), 343.

[2]Banking Act (Glass-Steagall Act), Statutes at Large, XLVIII, ch. 89, secs. 8, 16 (1933), U.S. Code, Vol. III, Title 12, sec. 227 (1964).

[3]Redford, American Government and the Economy, p. 531.

[4]Thomas, Modern Banking and Monetary System, p. 59.

insure individual deposits of commercial banks for $2,500, but this amount has gradually increased to its present maximum of $15,000 per depositor. All national banks and most state banks are members. State-chartered banks may elect to have their accounts insured by the federal agency. At present over 95 per cent of the nation's banks and about three-fifths of all bank deposits are insured.[1] Of significance to a later chapter of this paper is the fact that the insured, state-chartered banks which are not members of the Federal Reserve System are subject to primary federal regulation by the Federal Deposit Insurance Corporation.[2]

The success of deposit insurance is dependent upon the soundness of the insured banks. In return for the protection, the insured banks submit to the examination of their accounts and records by federal agencies. The Federal Deposit Insurance Corporation exercises primary responsibility for the conduct of these examinations, the purpose of which is to ascertain the bank's financial condition and the soundness of its banking operations. The Corporation itself examines the records of insured nonmember banks and accepts the reports of the Comptroller of the Treasury with regard to national banks, and of the Board of Governors of the Federal Reserve System with regard to state banks that are members thereof.

Prior to 1933, the most important piece of restrictive legislation against group banking was section seven of the

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[1] Redford, American Government and the Economy, p. 531.

[2] See *infra*, p. 107.

Clayton Antitrust Act.[1] The Federal Reserve Board first noted the existence of bank holding companies in 1927.[2]

Although the Banking Act of 1933 was not primarily designed to regulate bank holding companies, it is significant that it provided for the first direct federal regulation of the holding company as applied to the banking industry. The law applied to holding companies with 50 per cent ownership or control of a bank, but only if the bank was a member of the Federal Reserve System. It stopped short of regulating the separation of ownership and control of banks and nonbank affiliates of bank holding companies. Rather, control over bank holding company activities was sought through requiring holding companies to obtain permission to vote the stock of any Federal Reserve member bank they controlled. In return, the bank holding company agreed to a number of conditions: (1) terminate all connections with all securities companies; (2) maintain reserves of marketable assets, other than bank notes, of specified amounts; (3) permit examinations of itself and of all affiliates by the Federal Reserve Board; and (5) publish statements of conditions as required.[3] Violations of the rules by national banks entailed the risk of the loss of

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[1]Antitrust Act (Clayton Act), Statutes at Large, XXXVIII, ch. 323 (1914), U.S. Code, Vol. III, Title 15, secs. 12-27, 44 (1964).

[2]Board of Governors of the Federal Reserve System, Annual Report, 1927 (Washington, D.C.: Government Printing Office, 1928), p. 31.

[3]Marcus Nadler and Jules I. Bogen, The Bank Holding Company (New York: Graduate School of Business, New York University, 1959), p. 13.

their charter. A state bank risked expulsion from membership in the Federal Reserve System, but not its charter. The 1933 Act did not require the nonmember banks affiliated with unregistered holding companies and insured by the Federal Deposit Insurance Corporation to submit to regulation.

Beginning in 1938, a series of bills was introduced to enlarge the purpose and scope of holding company regulation. In that year President Roosevelt specifically mentioned bank holding companies with respect to his general recommendation to strengthen the nation's antitrust laws to prevent further concentration of economic power:

> . . . Congress enact at this session legislation that will effectively control the operation of bank holding companies; prevent holding companies from acquiring control of any more banks, directly or indirectly; prevent banks controlled by holding companies from establishing any more branches; and make it illegal for a holding company, or any corporation or enterprise in which it is financially interested, to borrow from or sell securities to a bank in which it holds stock.[1]

The weaknesses of the 1933 legislation are obvious. In 1943, the Board of Governors of the Federal Reserve maintained that (1) effective control of a bank might not require a majority of stock, (2) a holding company could avoid regulation by increasing control without voting its stock, and (3) that, more serious, the Board's only regulatory weapon was cancellation of registration, thus depriving the holding

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[1]U.S., Congress, Senate, Message from the President of the United States, Transmitting Recommendations for Strengthening and Enforcement of Antitrust Laws, S. Doc. 173, 75th Cong., 3d Sess., 1938, pp. 5-6.

company of voting rights of the member bank.[1] Additionally, except for transactions in securities, the regulation of bank holding companies was not directed toward the federal control of their activities in expanding existing or in acquiring nonbanking enterprises. The Board expressed the opinion that the operation of both banking and nonbanking subsidiaries by holding companies was "axiomatically wrong," that holding companies were a method of escaping state laws against branch banking, and that unregulated expansion of holding companies gave them an unfair advantage over other banks. The Board concluded the report with the observation that the bank holding company structure was potentially dangerous and recommended that "immediate legislation be enacted preventing further expansion of existing bank holding companies or the creation of new bank holding companies."[2]

Bank Holding Company Act of 1956

Between 1938 and 1956 Congress conducted hearings on numerous bills to provide increased regulation of bank holding companies. Fifteen bills were introduced between July 21, 1949, and July 28, 1955.[3] Finally, on May 9, 1956, H.R. 6227

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[1]Board of Governors of the Federal Reserve System, Annual Report, 1943 (Washington, D.C.: Government Printing Office, 1944), pp. 34-36.

[2]Ibid., p. 37.

[3]Gerald C. Fischer, Bank Holding Companies (New York: Columbia University Press, 1961), p. 58.

became Public Law 511 of the Eighty-fourth Congress--The Bank Holding Company Act of 1956.

The expansion of certain bank holding companies to positions of great power, particularly in the western United States, was a major factor leading to the enactment of the regulatory action. An outstanding example of the scope of this expansion was the Transamerica Corporation:

> . . . Transamerica Corporation . . . by the end of 1948 had acquired 41 banks operating a total of 619 banking offices in Arizona, California, Nevada, Oregon, and Washington. By that date, Transamerica banks accounted for more than 40% of all banking offices and over 50% of all commercial bank deposits in the five states. Between December 31, 1933 and December 31, 1948 the Transamerica group acquired 126 banks and established 74 new branches in the five-state area. Moreover, it owned and operated a wide variety of nonbank businesses with aggregate resources of over $275 million. These businesses included real estate, insurance, the manufacture of diesel engines, and the buying, processing, and selling of fish and seafood.[1]

The purpose of the Bank Holding Company Act is two-fold: (1) to prevent undue concentrations of banking resources from being controlled by any bank holding company; (2) to require the divestiture of nonbanking interests by bank holding companies. Accordingly, it provides for the regulation of three principal activities: (1) the formation and registration of holding companies, and the further acquisitions of banks by these companies; (2) the types of permissible nonbanking businesses authorized for registered companies, with the requirement for divestiture of unauthorized activities; and (3) financial

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[1] William F. Upshaw, "Federal Regulation of Bank Holding Companies--I," *Federal Reserve Bank of Richmond: Monthly Review*, October, 1968, p. 4.

and other relationships between registered companies and their subsidiaries.

A bank holding company is defined as any company which directly or indirectly controls 25 per cent or more of the voting stock of two or more banks, or that controls the election of a majority of the directors of two or more banks.[1] Companies that come under the definition are required to register with the Board of Governors of the Federal Reserve System. "The decision to have the Federal Reserve administer the 1956 Act, however, is not surprising for it was already administering the bank holding company provisions of the Banking Act of 1933."[2]

In addition to the general exemption for one-bank holding companies, there are a number of exemptions contained in Section 4(c) of the act, the most important of which are: (1) a bank holding company registered under the Investment Company Act of 1940[3] prior to May 15, 1955 (Morris Plan Corporation of America now called Financial General Corporation); (2) nonprofit religious, charitable and educational organizations; (3) a bank holding company which is a labor, agricultural or horticultural organization and which is exempt from taxation under Section 501 of the Internal Revenue Code of 1954; and (4) nonbanking assets of banks and holding companies that are

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[1]See supra, n. 2, p. 3.

[2]Fischer, Bank Holding Companies, p. 72.

[3]Investment Company Act, Statutes at Large, LIV, ch. 686 (1940).

considered by the Board of Governors of the Federal Reserve System to be so "closely related" to banking as to be a "proper incident thereto" and therefore not required to be divested by the bank holding company. The Board emphasized that these exemptions have weakened the law and has asked for their repeal on grounds that they cannot be justified in principle.[1]

It was noted in the preceding chapter that the exclusion of one-bank holding companies from federal regulatory controls provided the legal basis for banks to form holding companies and, in addition, to invest in nonbanking assets without the necessity of registering as a bank holding company. The prohibition of nonbanking interests by registered bank holding companies was an attempt by the legislators to prevent potential abuses by the management in common to both banks and nonbanking organizations. It is rational to assume that abuses that could occur between a nonbanking company and two banks could also occur between a nonbanking company and one bank.

Bank Merger Act of 1960

It was not until the middle part of this century that banks became threatened with litigation under the antitrust laws. Bank mergers were looked upon as a means of "rescuing foundering institutions rather than a path to monopolistic

[1]U.S., Congress, Senate, Committee on Banking and Currency, Report of the Board of Governors of the Federal Reserve System on Bank Holding Companies, S. Doc. 83, 85th Cong., 2d sess., 1958, p. 8.

restraints"; moreover, it was "felt that since banking was regulated by specific Federal and State statutes the antitrust laws did not generally apply."[1] Prior to 1948 the actions taken by the Department of Justice to apply the antitrust laws to the banking industry were minimal and met with limited success.

During the late 1940's the acquisitions of stock and/or assets of commercial banks by nonbanking corporations came under administrative and legislative scrutiny. The Board of Governors of the Federal Reserve System, in a major test of the Clayton Antitrust Act, initiated a proceeding against the Transamerica Corporation under sections seven and eleven, alleging the systematic acquisition of the voting stock of independent banks in five states. The result of this action was a 1952 order by the Board to Transamerica to divest itself of forty-seven banks, but it was set aside by a circuit court of appeal and the Supreme Court did not review the decision.[2]

In 1950, the Celler-Kefauver amendment[3] to the Clayton Act was passed by Congress and brought corporate merger by asset acquisition as well as stock acquisition within section seven of the Clayton Act. Provisions for the regulation of of bank mergers were not included in this legislation.

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[1] U.S., Comptroller of the Currency, "Currency in Historical Perspective," p. 9.

[2] *Ibid.*

[3] *Act of December 29, 1950* (Celler-Kefauver Act), *Statutes at Large*, LXIV, ch. 1184 (1950), *U.S. Code*, Vol. III, Title 15, secs. 18, 21 (1964).

It was not until the passage of the Bank Merger Act of 1960[1] that Congress provided specific legislation for the federal control of bank mergers. The pattern of that act was to require the scrutiny of banking combinations by the three federal banking agencies and the Department of Justice. Responsibility for approval of bank mergers rests with a single agency after consideration of the views of the other two agencies and the Department of Justice on the competitive aspects of the merger. Responsibility for control over the merger of federally insured banks was given to the Federal Deposit Insurance Corporation for banks which are not members of the Federal Reserve System, to the Comptroller of the Currency for national banks and to the Federal Reserve Board for state member banks. The only banks not affected by this legislation are the small and insignificant number of banks that are nonmembers of the Federal Reserve System and also not insured by the Federal Deposit Insurance Corporation.

In acting upon an application, the appropriate agency must consider certain factors as applied to each bank involved in the merger. These are: (1) its financial history and condition; (2) the adequacy of its capital structure; (3) the general character of its management; (4) its future earnings prospects; (5) the convenience and needs of the community, and whether or not its corporate powers are consistent with the

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[1] Act of May 13, 1960, Statutes at Large, LXXIV, Pub. L. 86-463 (1960); U.S. Code, Vol. III, Title 12, sec. 1828 (1964).

purpose of the act.[1] It is clear that Congress meant for the decisive factors in the determination of a bank merger ruling to be solvency, convenience and competitive effect.

Bank Holding Company Act Amendment of 1966

In 1966, the Bank Holding Company Act was amended.[2] Extensive revisions were incorporated in this legislation, the main thrust of which was aimed at bringing the Bank Holding Company Act into conformity with the Bank Merger Act of 1960.

Under Section 3(c) of the 1956 Act, the Board of Governors must consider five factors in any formation or acquisition case. These are: (1) the financial history and condition of the company or companies and the banks concerned; (2) their prospects; (3) the character of their management; (4) the convenience, needs, and welfare of the communities and the areas concerned; and (5) whether or not the effect of the acquisition or merger would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of banking competition.

Problems were minor in deciding individual cases with respect to the first three factors; however, in applying the third and fourth, the Board experienced major difficulties in

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[1] Board of Governors of the Federal Reserve System, Annual Report, 1960 (Washington, D.C.: Government Printing Office, 1961), p. 96.

[2] Act of July 1, 1966, Statutes at Large, LXXX, Pub. L. 89-356 (1966).

balancing considerations affecting competition and the public interest under the fifth factor and those affecting convenience and needs under the fourth.[1] Essentially, the problem was one of reconciling public utility-type standards relating to the convenience, needs, and welfare of the affected communities with antitrust factors involving competition and banking concentration. As a consequence of this problem, both the Bank Merger Act and the Bank Holding Company Act were amended in 1966[2] to provide uniform standards for judging proposed mergers or consolidations by banks, proposed bank holding company formations and proposed acquisitions by bank holding companies. The former criteria was replaced with substantially the identical language in the amending legislation.

Section 7(c) of the Bank Holding Company Act now provides that the Board shall not approve

> any acquisition or merger or consolidation which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or attempt to monopolize the business of banking in any part of the United States, or any other proposed acquisition or merger or consolidation whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anti-competitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

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[1] Board of Governors of the Federal Reserve System, "Application of First New York Corporation *et al.* to Become Bank Holding Company," *Federal Reserve Bulletin*, August, 1958, pp. 909-12.

[2] *Act of February 21, 1966, Statutes at Large*, [illegible], Pub. L. 89-356 (1966).

This provision is immediately followed by a directive that the Board "in every case, take into consideration the financial and managerial resources and future prospects of the company or companies and banks concerned, and the convenience and needs of the community to be served." The essence of the "convenience and needs" provision is that the Board may approve proposed expansions and acquisitions even in those cases which were previously considered to be in violation of antitrust laws.

Securities Acts Amendments of 1964

One of the major industrial reforms implemented by the proponents of the "New Deal" politics in the 1930's provided for the regulation of the securities industry. The Securities Act of 1933[1] and the Securities Exchange Act of 1934[2] are the major laws passed in the furtherance of this reform. Basically, the Securities Act provides for the public disclosure of the disclosure of the character of securities transactions in interstate and foreign commerce and the Exchange Act provides for the federal regulation of the securities exchanges and over-the-counter markets. The common purpose of these acts is to protect the public from fraudulent sales of securities and the prevention of unfair practices by manipulators in the markets.

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[1] Securities Act, Statutes at Large, XLVIII, Ch. 38 (1933).

[2] Securities Exchange Act, Statutes at Large, XLVIII, Ch. 404 (1934).

Although the three federal banking agencies, in the exercise of their supervisory powers, require banks to submit numerous and diverse reports concerning their financial operations, banks were not subject to the public disclosure provisions of these acts. Thirty years after the passage of the original legislation, both the 1933 and 1934 acts were amended to bring banks subject to the federal disclosure statutes.[1]

The importance of the banking industry is obvious. Since the Colonial period, it has risen from the relatively insignificant economic influence of a few small banks to one which under today's dual banking structure has some 14,000 banks and exerts a powerful role in the economic growth of this country. It is also obvious that the direction and purpose of governmental regulation and control of the banking industry has mainly been reactionary. In a democratic society, where the overconcentration of power by a central government is traditionally suspect, reaction rather than action is the norm. The result has been the evolution of an extensive system of structural and operational controls over the banking industry.

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[1] <u>Financial Institutions Supervisory Act, Statutes at Large</u>, LXXX, Pub. L. 89-595 (1966).

CHAPTER III

DEBATE OVER THE PROPER BUSINESS OF BANKING

With regard to the absence of federal jurisdiction and control over the activities of one-bank holding companies, the significance of the definition of a registered bank holding company, as set forth in the Bank Holding Company Act of 1956, was addressed in the introductory chapter to this paper. In this chapter, the discussion will be addressed to the factors responsible for the recent prominence of the one-bank holding company structure. It will be demonstrated that these factors reveal a basic problem which begs the question of what constitutes the business of banking.

There were 783 one-bank holding companies as of December 31, 1968.[1] For the purposes of this study, it is helpful to categorize these companies as follows: (1) the "traditional" one-bank holding company, (2) the "conglomerate" company, and (3) the "congeneric" bank holding company.

The traditional form comprises the majority of the 783 such companies mentioned above. Most often, these involve small banks in which, for one reason or another, it has been found feasible or attractive to have ownership in the corporate form. Ralph L. Zaum, a former president of the

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[1]See *supra*, p. 5.

Independent Bankers Association of America, has credited the federal and state income tax advantages of the corporate form as the major reason for the existence of the traditional one-bank holding company structure and has emphasized that they are, in most cases, closely held family corporations.[1] The usual situation is one in which a prominent local family owns the bank, the insurance company, the real estate agency, and the mortuary in a small town. Many of these are long established companies.

The conglomerate form is one in which the business of banking is incidental to its major activity or is of minor importance to its total activity. Traditionally, this organizational structure has involved small or medium sized banks which function primarily as a facility for the convenience of employees. Within recent years, however, large nonbanking corporations have acquired banking institutions as part of their general diversification plans, which may include a variety of corporate businesses, and for the most successful operation of which it is felt that the ownership of a bank will be useful.[2]

The congeneric form of one-bank holding company is one in which the bank is intended to be the major component

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[1] U.S., Congress, Senate, Committee on Banking and Currency, Bills to Amend the Bank Holding Company Act of 1956, Hearings, before the Subcommittee on Financial Institutions, Senate, on S. 2353, S. 2418, and H.R. 7371, 89th Cong., 2d sess., 1966, p. 120.

[2] For examples of this corporate form, see infra, pp. 78-79.

thereof. It is distinguished by two principal features: (1) the holding company structure is initiated by the shareholders of an existing bank;[1] and (2) the other components of the holding company are engaged in activities which are financial in nature or reasonably related to the business of banking. The term "financial congeneric" has been given to this form of corporate enterprise.

> The word "congeneric" may be defined as a planetary system allied in nature, character, or action. When . . . the word "financial" [is added], you are inferring . . . to a type of financial system which includes within its parts a scattering of related financial businesses.[2]

Within the past year, about fifty such holding companies have been organized or are in the process of organization.[3] As set forth in Chapter One, in most cases the banks involved are of substantial size, and the aggregate deposits of these banks are greater than those of the eighty-three registered bank holding companies.

Factors Leading to the Organization of Financial Congenerics

To understand the reason for the appearance of financial congenerics, it is necessary to review several relatively recent developments of significance to banks. It is these

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[1] For the mechanics of this process, see *supra*, pp. 3-4.

[2] Galusha, "Congress Should Define Scope of Financial Congenerics," p. 4.

[3] Richard P. Cooley, "One-Bank Holding Company Boosts Banks' Competitive Abilities" (address before a meeting of the Security Analysts of San Francisco, Calif., Nov. 5, 1968), published in *American Banker* (New York), Nov. 22, 1968, p. 4.

developments which give substance to the claim: "the financial congeneric is not a cause, it is an effect! It is a reflection of change in the basic role of the banking industry which seems to be in progress in this nation."[1]

During the decade of the 1930's, commercial banking fell heir to the most complete set of regulatory restraints in its history.[2] The enactment of these restraints, like most of the nation's prior banking legislation, followed a period of economic collapse.

It is a trite expression, but nevertheless correct, to note that the world of today is far different from that which prevailed a third of a century ago; when regulation was deemed to be the road to salvation for a large segment of America's industrial well-being, competition was frowned upon, and demand deposits and business loans were thought to be the natural functions of commercial banks. The rejection of competition and the endorsement of regulation or supervision as a means of restoring the health of the economy was pervasive. Such legislation as the National Industrial Recovery Act[3] illustrates the intensity with which economic growth through government regulation was intended to replace the free mechanism of the marketplace.

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[1]Gerald C. Fischer, "The New C's of Credit: Conglomerates, Congenerics, and the Clayton Act" (paper presented before the Banking and Financial Research Committee Workshop of the American Bankers Assn., Chicago, Ill., Oct. 1, 1968), p. 15.

[2]See <u>supra</u>, pp. 31-36.

[3]<u>National Industrial Recovery Act, Statutes at Large,</u> XLVIII, ch. 90 (1933).

A most significant development has been the policy of the federal government to employ its monetary and fiscal powers toward the fruition of a high level of employment and a stable price level, as expressed in the Employment Act of 1946,[1] thereby precluding another depression of the intensity of the one during the gloomy 1930's.[2] The banking industry, by its very nature, has played and is playing an integral role in the maintenance of these objectives.

There have been several other developments of significance to commercial banking, developments which have slowly been gathering momentum while changing the basic role of banking in the American economy. Moreover, within the past few years they have accelerated. The result has been the recent rush by banks across the nation to adopt the financial congeneric structure.

These developments may be categorized for discussion in the form of the sub-roles played by forces which have contributed to the changing role of the banking industry. The players are: (1) the Board of Governors of the Federal Reserve, (2) the technological innovators and the bank customers, (3) the attitudes of investors, and (4) the United States Department of Justice.

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[1] Employment Act, Statutes at Large, LX, ch. 33 (1946), U.S. Code, Vol. III, Title 15, secs. 1021-25 (1964).

[2] Carter H. Golembe, "The Nature and Control of One-Bank Holding Companies," Washington Financial Reports, Oct. 7, 1968, p. T-7.

The Board of Governors of the Federal Reserve

The full emergence of the Federal Reserve as a central bank after 1933 has been evolutionary in its effect on the changing nature of the banking business. Banks have entered into the type of deposit and lending business from which they have refrained in earlier years.

> . . . The impact was delayed by World War II, as well as by the preponderance of bank assets in the form of U.S. obligations. But since 1951, when the Federal Reserve recovered its independence from wartime financing constraints, it has been quite clear that if commercial banks were to grow at a pace consistent with demands of the economy, it could not be through dependence on demand deposits. Thus the years since 1951 have seen a remarkable growth in savings and time deposits in commercial banks while the growth of demand deposits has been much slower.[1]

When the Federal Reserve, in 1961, encouraged development of the negotiable deposit certificate and raised the ceiling on savings to 4 per cent, the result was an acceleration in the growth of savings and time deposits, but it was not without costs. A revolution in bank deposit competitiveness was unleashed and banks have had to pay increasingly higher interest rates to attract customers.[2]

> . . . In the process, bank credit growth soared while profit margins fell, putting bank managements under severe pressure to maintain acceptable earnings levels for

[1] Ibid., p. 6.

[2] David C. Cates, "Perspective on the Rush to One-Bank Holding Companies," Bankers Monthly, September, 1968, p. 22. The maximum rate under Regulation Q was set by the Federal Reserve Board at 2½ per cent in January 1936. It was raised to 3 per cent on January 1, 1957, to 4 per cent on January 1, 1962, to 4½ per cent on November 24, 1964, to 5½ per cent on December 6, 1965, and to 6¼ per cent on April 19, 1968.

> perplexed shareholders who saw--in contrast to the 1950's--deposits growing faster than earnings.[1]

Richard P. Cooley, president of the Wells Fargo Bank of San Francisco (the eleventh largest in the United States), has referred to the triple increase in the interest costs of time deposits as a major reason for the decision of Wells Fargo to form a one-bank holding company, a move which will provide the bank easier access to new fields where money, credit, and financial services could be profitably employed.[2]

It is appropriate to note that the Federal Reserve, by effecting policy which stimulated the growth of costly time deposits, stimulated an appetite for profitable assets which traditional banking practices could not fully satisfy. The banking industry, in meeting this challenge, has developed a new breed of managers who have a broader perspective than the bank managers of earlier generations. These men have the education and energy to find profitable uses for idle time deposits. "It is a paradox that the Federal Reserve, the source of the basic stimulus, has been severely criticized for excessive supervisory restrictions on the use of funds."[3]

With respect to the ability of the management of the emerging one-bank holding companies to meet the challenges of today's changing environment, fear has been expressed over whether bank managements can do justice to the traditional banking business as well as to the other businesses which may

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[1] Ibid.

[2] Cooley, "One-Bank Holding Company Boosts Banks'," p. 4.

[3] Cates, "Rush to One-Bank Holding Companies," p. 22.

be formed or acquired. Professor Gerald C. Fischer discounts this concern:

> . . . a similar argument could be presented for almost any significant growth of a bank or any major change in the operations of a financial institution. The senior banking officers of the larger banks, which are really the dominant group in the congeneric activity, are much more managers than bankers in the conventional sense. Moreover, the introduction of the challenge and diversity of a congeneric might be the very ingredient some institutions need to destroy the image of routineness which has affected bank recruiting for decades and offers a challenge and the financial rewards to get the best of the college crop into this industry.[1]

Indeed, the financial congeneric development is viewed as an infusion into the banking industry of "much needed new life," wherein the line of "advancement, participation in policy formation, and higher pay will be greater in semi-autonomous companies than in a large single-bank."[2]

Technological Innovators and the Bank Customers

It is not within the scope of this paper to trace the history of the technological revolution as applied to the banking industry. It is sufficient to note that within the last decade the industry has progressed from the Magnetic Ink Character Recognition milestone to blueprints for a cashless, checkless payments system, a progression which has been dependent on the useful application of the enormous efficiency of electronic computer processing machinery. The changing technology has brought about a shift in attitudes apropos to

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[1] Fischer, "Congenerics and the Clayton Act," p. 8.

[2] A. M. Youngquist, "One-Bank Holding Companies--Prospects Now," Bankers Monthly, November, 1968, p. 5.

consumer demand for banking services, which can be attributed to the rising expectations of the public and to the result of innovations by commercial banks. The latter is probably predominant, but the important point is that the demand exists. Individuals, businesses, tax exempt institutions, and local governments are looking to banks for convenient new services either related to banking or considered incidental to the business of banking, the result of which commands the expansion of the traditional banking functions.

Attitudes of Investors

Directly related to the problem of increasing costs for funds supplied by bank customers is the maintenance of satisfactory attitudes toward banking by the investment public. Large publicly held companies must compete for the shareholder's favor. It is not unreasonable to assert that "stockholders often have a loyalty no greater than their capital-gains tax liability."[1] Bank managers must justify their performance to shareholders on the basis of dividends, earnings growth and marketability.

In relation to earnings and book-value, the marketability of bank stocks during 1968 was at the lowest level since the 1950's.[2] Obviously, investment capital for banking has been diluted by the lure of greater capital-gains in other kinds of corporate enterprise.

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[1]Cates, "Rush to One-Bank Holding Companies," p. 24.

[2]Ibid.

One prominent bank stock analyst identifies two reactions to the relatively low value of bank stocks: (1) non-banking business managers, who realize the underlying potential of banking, act on opportunities to acquire control of banks at reasonable costs; and (2) the vulnerability to changes of control of banking entities spur existing managements toward adopting the congeneric structure, the announcements of which serve to inform investors that management is progressive and that future earnings will be higher, thereby causing favorable action in the trading of the applicable bank stock.[1]

The United States Department of Justice

Underlying the permissiveness of the Federal Reserve, the technological advances in the banking industry, and the concern of investors has been a change in the philosophy of what role competition ought to play in banking.

During the 1930's, the congressional purpose of banking legislation, in an effort to eliminate the deleterious effects that excessive competition held for the solvency of banks, was focused toward the application of competitive restraints on the banking industry. Since then, "by statutory direction and by judicial interpretation, commercial banks are constantly prodded to engage in a degree of competition which would have been unthinkable in the early 1930's."[2]

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[1] Ibid.

[2] Golembe, "Control of One-Bank Holding Companies," p. F-7.

Approximately 1,500 mergers, consolidations and absorptions of banks occurred in the United States between 1950 and 1960.[1] Despite these acquisitions in an industry noted for relatively high levels of concentration in many geographic markets, there was general, though not unanimous, agreement throughout the banking community that the antitrust laws did not cover mergers in that industry. The Supreme Court decision in United States v. Philadelphia National Bank[2] on June 17, 1963, however, clearly established that banks were subject to the antitrust laws.

In arriving at the decision, the Supreme Court rejected the "public interest" criteria contained in the Bank Merger Act of 1960, which the bank supervisory agencies are directed to consider when evaluating the merits of a given bank consolidation; and stressed the anticompetitive effects of such a merger:

> . . . We are clear, however, that a merger the effect of which "may be substantially to lessen competition" is not saved because, on some ultimate reckoning of social or economic debits and credits it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended paragraph 7 [Celler-Kefauver amendment to the Clayton Act], Congress determined to preserve our traditionally competitive economy. It therefore proscribed

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[1]Gerald C. Fischer, American Banking Structure (New York: Columbia University Press, 1968), p. 276.

[2]U.S. v. Philadelphia National Bank, 374 Wyatt (U.S.), 321 (1963). Hereafter called the Philadelphia case. Two earlier cases involving bank holding companies were challenged under paragraph 7 of the Clayton Act, but neither was heard by the Supreme Court--Transamerica Corporation v. Board of Governors of the Federal Reserve System (1948), and U.S. v. First America Corporation (1958).

anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid.[1]

With regard to financial congenerics, the importance of the Philadelphia case is that the decision is deemed to prevent effective challenges of mergers between banks and other types of financial institutions:

> To win in Philadelphia, the government lawyers had to argue that the deposit function was a bank's line of commerce, and therefore that the proposed merger with Girard Trust led to an anti-competitive share of the relevant market.
>
> But look what happens: If "banking" (narrowly defined) does indeed constitute a market totally distinct from consumer finance, . . . etc., then bank-congeneric acquisitions cannot possibly produce a concentration of economic power [by banks]. If on the other hand, the department were to challenge congenerics on the basis of specific "lines of commerce," then the so-called "concentration ratios" in bank-to-bank mergers (calculated largely on deposit and loan share-of market) would logically have to be reduced in terms of the particular financial markets involved.[2]

The import of this observation is that the action taken by the Justice Department in the Philadelphia case has provided added legal basis for one-bank holding companies to acquire nonbanking financial institutions.

It is now apparent why financial congenerics have been organized in recent months. A burgeoning economy is making ever larger and more complex demands upon the banking industry. Substantial changes in the deposit mix of banks have added significantly to their costs, while technological developments hold out promise for substantial savings. Bank managers are

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[1] Fischer, American Banking Structure, p. 311.

[2] Cates, "Rush to One-Bank Holding Companies," p. 25.

being urged to become more competitive, while at the same time banking is still subjected to the fairly restrictive "strait-jacket" woven by the regulatory legislation enacted during the past thirty-six years. Moreover, when attempts are made to react to these pressures, banks frequently find that the Federal Reserve is unsympathetic to expansion, or as will be developed later in this chapter, that competitors in fields which banks attempt to enter bend every effort to restrain the banks on grounds that the particular activity concerned is not "proper" to the business of banking.

Interpenetration of the Financial Markets

The underlying pressures identified above have caused banks and nonbanking financial intermediaries to penetrate each other's historical preserves. Areas invaded by commercial banks include bond underwriting, mortgage services, credit cards, mutual funds, insurance, electronic data processing, equipment leasing, and factoring. Activities of this kind are being conducted directly by operation components of the banks and/or indirectly through corporate subsidiaries.

Interpenetration is not a one-way street. Nonbanking financial institutions have acquired banking interests. The largest independent financial institution in its field, C.I.T. Commercial Corporation, entered commercial banking in 1965 through the acquisition of Meadowbrook National Bank of New York. The subsequent merger of Meadowbrook with the Bank of North America resulted in the control of 1.6 billion dollars of bank resources through ninety offices in metropolitan New

York by the banking subsidiary of C.I.T., now known as the National Bank of North America.[1]

It is apparent that banks and other financial organizations will intensify their competition. As the competition increases, each form can be expected to take on more of the services of its competitors in an attempt to avoid an earnings squeeze through diversification. It is reported that banks believe the tying of credit card and check credit services to be the most effective weapon in the competition for loans with nonbanking financial organizations.[2] Arthur H. Courshon, president of the National League of Insured Savings and Loan Associations, believes that the savings and loan industry is going to have to "press hard for competitive tools to meet the challenge the banks represent."[3]

The entry of banks into activities not related to their historical operations has not only met increased competitive resistance in the financial markets, but has encountered organized opposition from other financial interest groups, opposition which challenges the banks' entry into these activities through the mechanism of legal process. The complaints are that banks are seeking to engage in activities which are

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[1]"Congress and the Congenerics," Bank Stock Quarterly, September, 1968, pp. 7-8. See *infra*, pp. 77-79; U.S., Congress, House, Committee on Banking and Currency, Unregistered Holding Companies (Patman Report), 1969, p. 48, for a list of nonbank institutions that have announced plans to purchase banks between September 1 and December 31, 1968. 77-79

[2]"Trends in Lending," Banking, LXI (July, 1968), 90.

[3]American Banker (New York), December 6, 1968, p. 2.

not "incidental" to the business of banking. One reputed authority on banking law, Henry Harfield, refers to these lawsuits as: ". . . the squeeze on the business of banking. The common denominator is the effort of organized commercial and financial groups to protect their profitable areas by compressing the permissible area of banking."[1]

The results of these litigations have been inconclusive; some have been favorable and others unfavorable to the banking interests. One thing is certain, the proceedings are expensive and time-consuming; they delay (if not restrict) operations in the disputed activities, and they involve complex and conflicting interpretations of existing law by the courts and state and federal regulatory authorities. To avoid the uncertainties of these legal confrontations is one reason why some progressive bank managements have opted to reorganize under the one-bank holding company structure. This device, as demonstrated in Chapter One of this paper,[2] allows the subsidiaries of the holding company to perform related banking services and operations formerly conducted (or attempted) by the operating units and/or subsidiaries of banks without interference by the regulatory agencies or undue fear of litigation.

The Business of Banking

The critics of the financial congenerics contend that the concept places banks in direct competition with nonbanking

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[1]Henry Harfield, "Sermon on Genesis 17:20; Exodus 1:10 (A Proposal for Testing the Propriety of Expanding Bank Services)," Banking Law Journal, LXXXV (July, 1968), 566.

[2]See supra, pp. 3-4.

financial organizations, the activities of which are not considered to be traditional to the business of banking. The advocates of the movement point out that banks have been competing with them all along, but that with the congeneric format they are able to compete on an equal basis.[1] Although the efforts of the adversaries become mere academic questions when viewed in the legal perspective of the one-bank holding company structure, it is appropriate to address the legal controversy centering around the question of just what the business of banking is. This is especially true when it is considered that the one-bank holding company corporate form may soon be brought under the regulatory jurisdiction of the federal government by forthcoming proposals to change existing banking legislation.

There is no dispute over the enumerated corporate powers of national banks,[2] but the existing law, specifically the National Bank Act as amended, "left the door open" as to just what the business of banking really is. There is no truly authoritative, short definition.

Progressive bank managers, seeking new sources of revenue, have sought to diversify their operations in such banking "related" activities as messenger services, computer processing services, travel accommodations, credit card services, general mortgage services, commingled funds investment services (mutual funds), and equipment leasing services. Their efforts, as mentioned earlier, have been challenged in

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[1] Cooley, "One-Bank Holding Company Boosts Banks'," p. 4.

[2] Listed in U.S. Code, Vol. III, Title 12, sec. 24 (1964).

the courts as not being incidental to the business of banking. By utilizing the one-bank holding company corporate form, these managements not only are free to engage in these activities but also to reach into such traditionally "unrelated" banking activities as merchandising, real estate brokerage services, and manufacturing.

In the absence of a legislative definition of what is financial and what is nonfinancial, as applied to the banking industry, it is extremely difficult, if not impossible, to specifically identify at any given time all the activities incidental to the business of banking. The writer has reached this conclusion by examining significant court decisions relevant to the issues at bar, several of which are documented below.

Incidental Powers Clause

The legal debate over what is considered to be the proper business of banking is largely concerned with the intent of Congress with respect to the inclusion of the "incidental powers clause" in the National Bank Act.[1] It will be helpful to consider the basis of presently conflicting views which, if not resolved, prevent the term from being considered for what it really is and what it really describes.

Two provisions of existing national law are involved in the controversy. These are 12 U.S.C. 21 and 12 U.S.C. 24(7), both of which are derived from the National Bank Act.

[1] U.S. Code, Vol. III, Title 12, sec. 24 (seventh) (1964).

The former contains a general provision that corporations formed under the provisions of the act are for the purpose of "carrying on the business of banking." The latter provides that a national bank shall have the power:

> To exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by loaning money on personal property; and by obtaining, issuing and circulating notes according to the provisions of this chapter.

It is natural that those who favor restricting the business activities of banks contend that the wording of 12 U.S.C. 24(7) is a statutory definition of the banking business. They assert that the legality of a particular banking activity should not be considered as incidental to the power to carry on the banking business, but rather as incidental only to the express powers set forth after the preposition "by" in the quoted provision.[1]

The advocates of this position hold that only from the more limited phrases or concepts of law can the measurement of the incidental powers contained in legislation be meaningfully determined. They are buttressed in their contention by a legal tradition to the effect that:

> The extent of the powers of national banks is to be measured by the terms of the Federal statutes relating to such associations, and they can rightfully exercise only such as are expressly granted, or such incidental

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[1] Ralph F. Huck, "What Is the Banking Business?" The Business Lawyer, January, 1966, p. 539.

> powers as are necessary to carry on the business for which they are established. . . . an incidental power can avail neither to create powers which, expressly or by reasonable implication are withheld, nor to enlarge powers given, but only to carry into effect those which are granted.[1]

This principle still stands; however, in applying it to the incidental powers clause, the banking critics have apparently ignored the grammatical construction of the words in question:

> . . . a semicolon appears after the initial clause of paragraph Seventh of section 24: . . . and that each of the subsequent clauses in that first sentence are also separated by semicolons. It is an established principle of statutory construction that every clause separated by a semicolon is of co-ordinate value, and that therefore each clause must be read separately in the sense that each clause must be given its own separate value and effect (McLeod v. Nagle 48 F. 2d. 189). The proponents of the narrow view would read this first sentence . . . as though it provided that banks shall have incidental powers to carry on the business of banking so long as and to the extent that such business consisted of and was limited to "discounting and negotiating promissory notes, drafts, bills of exchange and other evidence of debt, receiving deposits, buying and selling exchange coin and bullion, and loaning money on personal security."
>
> Obviously such an attempted construction reaches the result desired by the proponents of the narrow view by eliminating separate consideration of what the simple but broad term "business of banking" encompasses; but such an attempted construction equally obviously violates the settled rule of statutory construction above referred to.[2]

The use of the semicolon throughout the first sentence of the disputed provision is not accidental. The original legislation, in 1864, contained no punctuation after the term

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[1]First National Bank v. Missouri, 263 Knaebel (U.S.), 640 (1923).

[2]Huck, "What Is the Banking Business?" p. 539.

"business of banking" and before the word "by." For this reason, in a case decided by an Ohio court in 1872,[1] it was adjudicated that the words "by discounting etc." were to be read as limiting and defining the kinds of banking activities authorized by the National Bank Act and that the incidental powers clause applied only to the enumerated banking activities.

Under the Revised Statutes of 1873, Congress amended the legislation by inserting a semicolon after the word "business" in the disputed sentence, thereby emphasizing that the incidental powers determination must be measured against the simple term "business of banking." It is obvious that it was the intent of Congress to give full effect to the doctrine of the co-ordinate value of the clauses separated by the semicolon as established in McLeod v. Naglo.[2] By clarifying the legislative intent of the incidental powers clause in 1873, Congress simply enacted into statutory law what had been recognized in jurisprudence since 1857 when a New York court said:

> The implied powers exist by virtue of the grant to do the business of banking, and are not enumerated and defined; because no human sagacity can foresee what implied

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[1]Shinkle v. First National Bank in Ripley, 22 Ohio 516 (1872).

[2]Huck, "What Is the Banking Business?" p. 540. See pp. 540-43 of cited reference for an historical account of congressional intent and purpose apropos the incidental powers clause, wherein it is concluded that the enumeration of certain banking functions in 12 U.S.C. 24(7) was intended to specify functions in addition to those which could be performed by nonbanking corporations.

> powers, may in the progress of time, the discovery and perfection of better methods of business, and the ever varying attitude of human relations, be required to give effect to the express powers. They are, therefore, left to implication.[1]

The Bank Messenger Service Case[2]

At issue in this case was a ruling by the Comptroller of the Currency which authorized the operation of a national bank of an armored car messenger service to pick up and deliver money and other items under contract from and to its customers.[3] The ruling required that the agreement between the bank and its customer must specify that the agent was the agent of the customer and that the deposits collected under the contract would not be considered as having been received by the bank until delivered to the teller at the bank's premises, and that a check is considered as having been paid at the bank when the money is handed to the messenger as agent for the customer.

On the basis of this ruling, the First National Bank instituted a service whereby an armored car owned by the bank and operated by its employee collected cash, checks and other items for the bank's customers for deposit to their accounts at the bank. It further constructed a concrete receptacle in

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[1] Curtis v. Leavitt, 15 New York 157 (1857).

[2] First National Bank in Plant City, Florida and William B. Camp, Comptroller of the Currency of the United States v. Fred O. Dickenson, Controller of the State of Florida, 274 F. Supp. 449 (1967); 400 F. 2d 548 (5th Cir. 1968).

[3] Comptroller of the Currency of the United States, Manual for National Banks, sec. II (Rulings), par. 7490.

a shopping center for the placement of night bags for pickup by the messenger, the understanding being that the messenger was the customer's agent for delivery of the deposit to the bank.

The operation encountered opposition from various Florida state banks and from the operators of messenger service establishments. The State Controller advised the bank that its messenger service was in violation of state law prohibiting branch banking, a law which provided that a bank's business shall be transacted only at its banking house.[1] The plaintiffs, claiming that the messenger service did not constitute branch banking, filed suit to enjoin the State Controller from interfering with its operations (previously cited), and cited a federal statute wherein a branch bank is defined as one in which deposits are received, or checks paid, or money lent;[2] and as such the operation could not be considered as conducting banking business off premises and, therefore, not in violation of the federal statute which prohibits such activity.[3]

On June 2, 1967, the United States District Court sided with the plaintiffs, ruling that the messenger service and off-premises receptacle were not branches within the meaning of federal statute and, therefore, did not violate Florida law. This decision was reversed on September 12, 1968,

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[1] Florida Statutes, sec. 659.06(1)(a).

[2] U.S. Code, Vol. III, Title 12, sec. 36 (1964).

[3] U.S. Code, Vol. III, Title 12, sec. 81 (1964).

by the United States Court of Appeals, which ruled that the Florida law, not the federal statute is controlling and operative.

The Appellate Court decision was based on the position taken by the United States Supreme Court in First National Bank of Logan v. Walker Bank and Trust Company (decided in 1966 and reported in 385 U.S. 252), wherein it was ruled that when Congress enacted legislation authorizing national banks to branch, it intended to place national and state banks on a "competitive equality" with respect to branch banking.

The essence of the final adjudication is that the measuring stick for the definition of what branch banking is, and thereby the authority to branch, is state law. Accordingly, in those states wherein branch banking is permitted, banks may operate the kind of messenger service involved in this case. In other states, they may not. It was pointed out to this writer that the court's action, which sustained the defendant's contention that the bank's messenger service operation constituted a form of branch banking, was an indirect adjudication that bank messenger services are activities incidental to the banking business.[1]

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[1] C. Westbrook Murphy, Director of Litigation for the Comptroller of the Currency of the United States, private interview held on January 10, 1969.

The Insurance Agency Case[1]

In 1963, the Comptroller issued a ruling which authorised national banks to act as agents in the issuance of insurance contracts incidental to the borrowing of funds to secure fixed and movable property.[2] Buttressed by this ruling, the Citizens and Southern National Bank of Georgia began selling to borrowers in Atlanta, Georgia, broad forms of automobile, home, casualty and liability insurance, a program which subsequently was extended to several cities in Georgia, all with a population in excess of 5,000 persons.[3]

The United States District Court, on March 31, 1967, held illegal, as a matter of law, the Comptroller's ruling; basing the decision on the implied prohibition of a provision of the National Bank Act which authorizes national banks, located in communities of 5,000 persons or less, to act as insurance agents under rules and regulations prescribed by the Comptroller.[4] In other words, the congressional grant of power to act as insurance agents in places of 5,000 persons or less impliedly prohibits such activity in places with a population in excess of that number.

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[1]Georgia Assn. of Independent Insurance Agents, Inc., v. James J. Saxon, Comptroller of the Currency of the United States, 268 F. Supp. 236 (1967); 379 F. 2d 1010 (5th Cir. 1968).

[2]Comptroller of the Currency of the United States, Manual for National Banks, par. 7110.

[3]379 F. 2d 1012.

[4]U.S. Code, Vol. III, Title 12, sec. 92 (1964).

The Comptroller's unsuccessful defense was based on the contention that the statute did not prohibit the selling of insurance that was incidental to the business of banking; that such selling was a valid banking function under the incidental powers clause; and that the enactment of the statute in 1916 was for the express purpose of providing insurance services in rural areas where it was not profitable for independent agencies to conduct operations, not impliedly to deny such activities to banks in metropolitan areas.[1]

On November 4, 1968, the Appellate Court upheld the District Court's decision that the Comptroller's ruling was illegal as matter of law, but also attacked the Comptroller's position that such activity was proper and incidental to the business of banking:

> . . . There is ample precedent for the conclusion that a power that has been withheld or denied by Congress cannot be found to exist as an "incidental" and "necessary" power and that principle has been applied several times to the National Bank Act.[2]

In reference to this case, the Director of Litigation for the Office of the Comptroller of the Currency of the United States, C. Westbrook Murphy, commented that it is a legal practice for the officers of banks to be the direct representatives of nonbank affiliated insurance companies and, therefore, the permitting of banks to act as independent agents in the

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[1] 379 F. 2d 1011.

[2] Ibid., p. 1014. The court cited: First Nat'l Bank in St. Louis v. State of Missouri, 263 U.S. 640, 44 S. ct. 213, 68L. Ed. 486 (1924); and Baltimore & Ohio Ry. Co. v. Smith, 56 F. 2d 7998 (3d Cir. 1932).

The United States District Court, on September 7, 1967, under the principle of "standing," decided the issue in favor of the national bank. The court refused to consider whether or not the "business of banking" included travel agency-type activities. The lack of standing decision was based on the fact that the plaintiffs could not prove a legal injury and that the National Bank Act contains no provisions for judicial review of the Comptroller's rulings (pertaining to travel agencies). In reaching the decision, the court cited a precedent case wherein the United States Supreme Court held that: "a party lacks standing to maintain a legal action where the only claimed financial loss is due to economic conditions."[1] The plaintiffs have appealed the decision.[2]

With regard to the question of whether or not travel agency-type activities are incidental to the banking business, nothing has been really settled by this case. The Comptroller's tactics, wherein a complaint is successfully defended for lack of standing, do not result in a meaningful resolution. Rather, the problem is placed in a sort of "limbo" until the peculiarities of a future case will be sufficient to render a decision on the merits, rather than on standing.

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[1] *Ibid.*, pp. 772-73.

[2] South Shore National Bank has since chosen the path of least resistance and is forming a one-bank holding company.

The Revenue Bonds Case[1]

The subject matter of this action was concerned with the authority of commercial banks to underwrite and deal in securities issued by states and political subdivisions. The case was unusual as it placed the United States District Court in the role of referee in a dispute between the Federal Reserve Board and the Comptroller of the Currency.

The specific problem involved conflicting interpretations of two provisions of the Glass-Steagall Act[2] prohibiting banks from underwriting securities or stock, but which makes an exception for general obligations of the United States, or any state or political subdivision thereof. The question at issue was whether or not the term "general obligations" includes all obligations issued on full faith and credit, even if such obligations were not backed by the taxing power.

Until 1963, both the Federal Reserve and the Comptroller construed the phrase to mean securities backed by the taxing power. However, on September 12, 1963, the Comptroller promulgated a regulation the effect of which extended the definition of general obligations to mean an obligation supported by the full faith and credit of the obligor, even if that obligor lacked the taxing power.[3] Thus was created, as the court said:

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[1]Baker, Watts and Company, *et al.*, v. James J. Saxon, Comptroller of the Currency of the United States, 261 F. Supp. 247 (1966).

[2]*U.S. Code*, Vol. III, Title 12, secs. 34, 35 (1964).

[3]Comptroller of the Currency of the United States, *Manual for National Banks*, par. 1310.

> . . . the anomalous and chaotic situation of the statute being applied in one way to State banks that are members of the Federal Reserve System, and in an entirely different manner to national banks, merely because two different agencies administer the law in respect to these two groups of institutions.[1]

On December 14, 1966, the court ruled in favor of the plaintiff's contention that Congress intended the "general obligations" exemption to be applicable only to securities of those state and political subdivisions possessing the taxing power. It specifically noted that when Congress enacted the Bank Act of 1933, the action was in response to the "tragic debacle" that shook the banking community in the 1920's, a situation aggravated by imprudent banking activity in the investment brokerage business. The court concluded that:

> The origin of the legislation . . . conclusively demonstrates that it was the unalterable and emphatic intention of Congress to divorce commercial banks from the business of underwriting and dealing in securities. Congress has never deviated from its position ever since the passage of the Act of 1933. It carved out an exception at the time for securities of Governmental bodies of certain limited types. No basis is discernible for broadening that exception. On the contrary, the original objective of the Congress should not be weakened or impaired unless it be by later legislative action.[2]

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[1] 261 F. Supp. 250.

[2] Ibid., pp. 249, 252. See: The Port of New York Authority v. Baker, Watts, & Co., et al., 286 F. Supp. 770 (1967), for the U.S. Appeals Court affirmation of the District Court's decision. Also see: Investment Company Institute v. William B. Camp, Comptroller of the Currency of the United States, 274 F. Supp. 624 (1967) for a similar application of the Glass-Steagall Act wherein a bank was enjoined to desist from the operation of a commingled investment account (mutual funds).

The Data Processing Case[1]

The problem presented in this case concerns the marketing of electronic data processing services by the defendant national bank. The bank, in response to a ruling of the Comptroller of the Currency which authorized national banks to make available data processing equipment or perform data processing services on such equipment for the general public,[2] engaged in such activities with the city of Providence, Rhode Island, and other such customers. Once again, the ruling was based on the Comptroller's interpretation of the incidental powers clause.

The plaintiff's contention was that since there was no provision in the National Bank Act wherein a national bank was specifically authorized to engage in the disputed activities, the ruling by the Comptroller granting such authority was, therefore, "in violation of the National Bank Act, beyond statutory authority, arbitrary, capricious, an abuse of discretion, and not in accordance with the law."[3] The plaintiff further cited Section 4 of the Bank Service Corporation Act[4]

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[1]The Wingate Corporation v. Industrial National Bank of Rhode Island, *et al.*, 288 F. Supp. 49 (1968).

[2]Comptroller of the Currency of the United States, *Manual for National Banks*, par. 3500.

[3]288 F. Supp. 51.

[4]*Bank Service Corporation Act*, *Statutes at Large*, LXXVI, Pub. L. 87-856, 76 Stat. 1132 (1962), *U.S. Code*, Vol. III, Title 12, sec. 1864 (1964). Removes all limitations of federal law exclusively relating to banks which would otherwise prevent banks from investing up to 10 per cent of their capital and surplus in bank service corporations, thereby allowing banks to benefit from the improved efficiency made possible by electronic data processing equipment.

which prohibits a bank service corporation from engaging in any activity other than the performance of bank services for banks.

Once again, the defense of "standing" was successfully raised; the case was not decided on the merits. The court, on July 25, 1968, found that the plaintiff could not show a legal injury, and therefore dismissed the complaint. In reaching the decision, the court declared that "neither paragraph Seven of 12 U.S.C. 24 nor said Bank Service Corporation Act reflects a legislative purpose to protect the plaintiff against the competition of which it complains."[1]

Apparently, since the defendant was a national bank and not a bank service corporation, the court was not impressed with the plaintiff's contention that the congressional purpose of Section 4 was to restrict banks from offering data processing services to the general public. It is noted that the American Bankers Association filed a brief on this case, in amicus curiae, which contained comprehensive documentation in support of that association's contention that it was not the intention of Congress to make the restrictive clause applicable to banks, but only against bank service corporations.[2]

The decision is docketed for appeal and this writer believes that the Appellate Court will be reluctant to affirm

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[1] 288 F. Supp. 56.

[2] Matthew Hale, Brief for the American Bankers Association Appearing as Amicus Curiae, U.S. Court of Appeals (1st Cir.), No. 7186 (case of The Wingate Corporation v. Industrial National Bank of Rhode Island, et al., Nov. 12, 1968), pp. 10-12.

the District Court's adjudication. The Bank Service Corporation Act was an obvious action by the Congress to enable small and medium-sized banks, through the achievement of economies of operations made possible by advances in automated data processing technology, to maintain a competitive position with the giants of the industry. It seems inconsistent that the Congress would intentionally abrogate such intent by restricting Bank Service Corporations from performing the same type of data processing services for the public as can the individual banks.

Conglomerate, Congeneric, or Consanguineous

Virtually every bank management within the past year which has opted to form a one-bank holding company has been specific in emphasizing the congeneric nature of the subsidiaries such holding companies would control. All would be engaged in financial services related to or allied with banking. The concern of those who fear that the new holding companies will enter into other lines of business than banking, and thereby become conglomerate organizations, are discounted by those managements. Rudolph A. Peterson, president of the Bank of America (the world's largest bank and presently effecting a change to the one-bank holding company structure), referred to financial congenerics as "a marriage of related finance" and has promised that "Macy's and Gimbels are perfectly safe." Richard P. Cooley (previously identified as chairman of the Wells Fargo Bank in San Francisco) emphasized that the Wells Fargo holding company will be kept

> congeneric in form rather than conglomerate, partly to avoid the possibility of additional regulation, but more importantly to keep management focused upon doing what it knows best. . . . In our bank we have little experience in other conglomerate type businesses, but we do know about financial business.[1]

Undoubtedly, these prominent, respected and reliable members of the banking community are sincere in these assertions; however, it still remains that the one-bank holding company format permits banks to extend their interests into almost any field they choose. Moreover, although the door has always been open for nonbanking holding companies to own controlling interest in one bank, activity in this area among the conglomerate operators has until recently caused little concern.

This is no longer true. During October, 1968, the Insurance Company of North America, an aggressive conglomerate organization (insurance, mutual funds, manufacturing), agreed to purchase 80.5 per cent of World Airways, an airline company which paid 63 million dollars for 99.3 per cent control of First Western Bank of Los Angeles four months earlier. First Western conducts operations through eighty branches in California and has assets of approximately 900 million dollars.[2] In commenting on the acquisition of the bank by World Airways, a respected authority on banking law, Warren W. Koffler, concluded that "a controlled bank represents a potentially useful tool to the parent corporation."[3]

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[1]Cooley, "One-Bank Holding Company Boosts Banks'," p. 4.

[2]Youngquist, "Holding Companies--Prospects Now," p. 6.

[3]Koffler, A Banking Primer," p. 40.

The Liberty Corporation, the parent company of Liberty Life Insurance Company (operates in twenty-two states and has assets of 238 million dollars) announced in November, 1968, that it had agreed to purchase the South Carolina National Bank, as well as proposed acquisitions in the broadcasting and real estate fields. In other commercial areas: Standard Prudential Corporation, a holding company of consumer finance and factoring units with reported aggregate annual sales of 180 million dollars, has agreed to purchase 84 per cent control of Sterling National Bank and Trust Company of New York (thirteenth largest in New York City); and Kinney National Service Incorporated, a diversified company engaged in building maintenance, parking lots, funeral chapels, and data processing services, has agreed to purchase the 150 million dollar Hackensack, New Jersey Trust Company for 25 million dollars.[1]

These acquisitions may be the forerunners of a wave of "take-overs" of banks by conglomerate enterprises. The banking community is acutely aware of this possibility and it was not with total levity that David Rockefeller, chief executive officer of the Chase Manhattan Bank of New York, when asked whether he was still the bank's largest shareholder, quipped: "I don't know. I haven't looked in the last hour."[2]

The accelerating proliferation of one-bank holding companies throughout the country has not gone unnoticed and

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[1]Youngquist, "Holding Companies--Prospects Now," p. 6.

[2]"Why Citibank Is More Than a Bank," *Business Week*, November 16, 1968, pp. 78-79.

has evoked expressions of concern from government officials as well as from officials of private interests. William McChesney Martin, in a prepared statement before the House Banking and Currency Committee said the subject

> . . . requires a very careful study and it can affect the whole capitalistic system in the United States, in my judgment. It evolves around the matter of banking and non-banking business. It revolves around conglomerates, congeneric activities, and I have used the word "consanguineous activities."[1] We are studying this hard now; and it is a very difficult problem. We have come to no conclusions and we are working with the Comptroller and with the FDIC and with the administration on it. It is a very very real problem and this problem I consider to be a very serious one.[2]

In the power contest to come, the interests of all will be vigorously asserted and the interests of some are going to be hurt in the final outcome. This much is certain: the accelerating trend to diversify the business of banking, regardless of corporate form, has already altered the regulatory atmosphere, and brought forth a new style of bank management. Whatever happens to the one-bank holding company as such, the development has dramatized the issue over the "proper" business of banking. There will never be a total regression to the "traditional" banking functions.

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[1]The distinction is fine, but clear. Webster's defines congeneric as "allied in origin, nature, or action"; and consanguineous as "of the same blood, descended from the same ancestor, of or pertaining to persons so related." Mr. Martin opts for the more restrictive.

[2]U.S., Congress, House, Committee on Banking and Currency, Federal Reserve Rulings, Hearings, before the Committee on Banking and Currency, House of Representatives, on Federal Reserve Rulings Regarding Loan Production Offices and Purchases of Operating Subsidiaries, 90th Cong., 2d sess., 1968, p. 48.

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CHAPTER IV

THE ONE-BANK HOLDING COMPANY AND THE PUBLIC INTEREST

It is no revelation that banks are private enterprises conducted for profit, or that one-bank holding companies are also profit centered entities. A bank, however, is entrusted with the handling of customers' deposits and is, therefore, a quasi-public institution. The commercial banking system is based on competitive elements which are controlled by the existence of antimonopoly characteristics formalized in the banking structure and banking law. Since banking has some public service characteristics, it is logical that the banking industry is regulated by a body of law which seeks to protect the public interest. It is, therefore, appropriate that the subject of the one-bank holding company and the public interest be discussed.

There are two basic public policy objectives that are relevant in evaluating any proposal for additional legislation to control the formation or activities of the emerging financial congenerics. One is the protection of the public against the burden of a bank failure. The other is to assure the continued existence of a competitive business environment by preventing an undue concentration of economic power. Excessive

economic power is considered harmful because of its anti-competitive effects and because it lends itself to self-dealing, favoritism and certain other illegal or unethical practices.[1]

The attention of this chapter is directed toward an inquiry as to the efficacy of present legislation and banking regulation to, in the furtherance of public policy, control the formation and activities of the one-bank holding companies. Attention will be focused on the issues of bank solvency and concentration of economic power. Two supplementary issues, however, will first be discussed. They are concerned with a problem of equity between the regulatory treatment of one-bank holding companies and registered bank holding companies, and with the dichotomy of opinion concerning the "loophole" apellation given to the definition of a registered bank holding company as set forth in existing legislation.

The Congeneric - Registered Bank Holding Company Inequity

The whole of the public interest is comprised of a balance, rather than a summation, of the individual and corporate interests of our society. Under the present banking legislation and the administrative interpretations thereof, the public that is served by banks which are under the regulatory umbrella of the Board of Governors of the Federal Reserve System are not free to enjoy many of the peripheral banking services offered by the financial congenerics. This situation is the basis for complaints that, in terms of the market in

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[1]Golembe, "Control of One-Bank Holding Companies," p. T-6.

which they compete, the congeneric enterprises enjoy a competitive advantage over the registered bank holding companies.

A provision of the Bank Holding Company Act permits registered bank holding companies to invest in the shares of any company all the activities of which are "financial, fiduciary, or insurance nature," which the Federal Reserve Board "after due notice and hearing" finds are so closely related to the business of banking as to be a proper incident thereto.[1] Traditionally, the Board has been very restrictive in its determination of the type of activities in which registered bank holding companies may engage. It is also significant that, due to the statutory requirement for hearings, often many months pass before the Board finally decides on a particular application by a registered bank holding company.[2]

Of interest is that the statutory language of the statute under discussion, in effect, provides legal justification for registered bank holding companies to establish financially related subsidiaries. All that is required is approval of such subsidiaries by the Federal Reserve Board. If the Board had been more liberal in its interpretation of what is and what is not proper to the banking business, it is interesting to speculate on whether or not the current rush by

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[1] Bank Holding Company Act, Statutes at Large, LXX, ch. 240, sec. 4(c)(8) (1956), U.S. Code, Vol. III, Title 12, sec. 1843(c)(8) (1964).

[2] "Congress and the Congenerics," Bank Stock Quarterly, September, 1968, p. 12. See: Published Interpretations of the Board of Governors of the Federal Reserve System (Washington, D.C.: Government Printing Office, 1966), pp. 671-72, for a listing of sec. 4(c)(8) determinations.

banks to form financial congenerics would have occurred. It is extremely probable that the rush would have been to form multiple-bank holding companies, instead of one-bank holding companies.

In retrospect, there would still be the financial congeneric problem. It would, however, be in relation to the multiple-banking structure, not to the one-bank structure. With respect to the delineation of the proper business of banking, it is difficult to assume that the competitors of banks in fields "related" to banking would not challenge the banking industry and the Federal Reserve Board in much the same manner as they have challenged the national banks and the Comptroller of the Currency. It is obvious that the Board's restrictive interpretation of what constitutes the business of banking has resulted in substantial avoidance of litigation by the Board's legal staff.[1]

A review of every hearing held before the banking and currency committees of Congress since 1933, relative to banks and bank holding companies, will reveal references to the Board's concern about the combining of banking and nonbanking interests under the same corporate roof. The Board's viewpoint has been consistent in that "each time Congress has considered the subject of bank holding companies the Board has

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[1]The Board's ruling of August 14, 1968, which authorized affiliates of registered bank holding companies and of state member banks to establish loan production offices and to operate subsidiaries through the purchase of stock will prove to be an exception to this general observation.

urged that the registration and divestment provisions should be applicable to one-bank holding companies."[1]

The option was clear. Banks had to decide whether their future path would be toward expansion through combination with other banks through holding companies or in diversification into other activities that, until now, had not been considered a part of banking. The answer, of course, has been the much publicized rush by banks to embrace the congeneric structure. The result--a severe inequity is being endured by the registered bank holding companies. The Association of Registered Bank Holding Companies officially addressed this problem in a statement submitted to the Board of Governors of the Federal Reserve System dated October 27, 1968:

> We believe that the movement of banks into one-bank holding companies is generally in response to the large, complex and new demands of an expanding economy upon banking institutions and the resultant desire of such banks to meet current and prospective financial needs of their communities. We share this desire and feel the same pressures to expand our services.
> . . . The Board in the past has construed this language [Section 4(c)(8) of the Bank Holding Company Act] in such a manner that registered bank holding companies have not been able to keep pace with the needs of their communities. We respectfully request that the Board adopt a

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[1]"Bank Diversification and Financial Congeneric Corporations" (monthly memorandum prepared for distribution to clients of Carter H. Golembe, Associates, Inc., Washington, D.C., August, 1968), p. 4. See *infra*, p. 88; and U.S. Congress, Senate, Committee on Banking and Currency, *Amend the Bank Holding Company Act of 1956, Hearings*, before a subcommittee of the Committee on Banking and Currency, Senate, on S. 2353, S. 2418, and H.R. 7371, 89th Cong., 2d sess., 1966, p. 58, for respective 1959 and 1966 position statements by the Chairman of the Board of Governors of the Federal Reserve System.

> policy that will permit registered bank holding companies to engage in legitimate, modern-day activities related to banking.
> . . . registered bank holding companies and their affiliated banks must be fully competitive with and no more severely regulated than one-bank holding companies and their banks. . . . if it is decided that one-bank holding companies would be permitted to acquire such corporations [engaged in activities unrelated to banking], then as a matter of equity, registered bank holding companies should be given the same privilege.[1]

It might be argued that no inequity exists in that there is a logical trade-off: the freedom of financial congenerics to compete in various areas offset by the inability to expand by means of acquiring more banks. The logic ignores the fact that many of the nation's largest banks, who have opted for the congeneric structure, are located in states wherein there are no restrictions on branch banking. Moreover, the congeneric affiliated banks, regardless of location, "may engage in activities from which its competitor bank is prohibited simply because the latter may be a part of a group of banks which includes, possibly two or three smaller, distant organizations."[2]

This writer, by personal interview and/or correspondence with influential members of the Congress, the Administration, the federal banking supervisory agencies, and the banking community itself, has uncovered an overwhelming

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[1]Association of Registered Bank Holding Companies, "Statement on One-Bank Holding Companies to the Board of Governors of the Federal Reserve System," Washington, D.C., Oct. 22, 1968. (Mimeographed.)

[2]"Congenerics--Once Again" (monthly memorandum prepared for distribution to clients of Carter H. Golembe, Associates, Inc., Washington, D.C., September, 1968), p. 7.

sentiment indicating that it would be unconscionable to allow the congeneric-registered bank holding company inequity to persist. There was only one contrary opinion, which, incidentally, was the parochial view of a prominent official of one of the largest banks in the United States, a bank which is currently converting to the congeneric structure. Kenneth A. Randall, chairman of the Federal Deposit Insurance Corporation, stated to the writer: "There should be no break; the registered bank holding companies must be permitted to enjoy the same benefits as the one-bank holding companies."[1] The statement exemplifies the general consensus that a more liberal interpretation of the statute by the Federal Reserve Board is needed to restore the competitive posture of the registered bank holding companies.

Loophole in the 1956 Act

It is, of course, redundant to mention that the statutory feature of the Bank Holding Company Act of 1956 which opens the door to the organizers of financial congenerics is the two-bank qualification in the definition of a registered bank holding company. This qualification, in recent months, has been reported in the financial columns of numerous newspapers, magazines, and journals and in the Patman Report as being a "loophole" in bank regulatory legislation. The charge bears investigation, but before a meaningful conclusion can be

[1] Kenneth A. Randall, chairman of the Federal Deposit Insurance Corporation, private interview held on Feb. 12, 1969.

reached, the term "loophole" must be placed in proper perspective.

If by "loophole" is meant an inadvertent omission in a statute or perhaps a deliberately contrived but hidden means to avoid a set of restrictions, then the term is not applicable either to the Bank Holding Company Act of 1956, nor to the amendments of 1966.[1] Public hearings were held by the Congress prior to the passage of these acts. A review of these hearings leaves no doubt that there was considerable congressional debate in 1955 and in 1956 as to whether or not to provide regulatory controls for the one-bank holding companies. In the course of the hearings incidental to the passage of the 1956 act, the chairman of the Board of Governors of the Federal Reserve System commented:

> . . . we believe the definition in this bill will not be adequate to effectuate one of the two main objectives of this legislation. It would not apply to a company which controls only one bank and would not, therefore, require such a company to divest itself of its nonbanking interests. Yet it seems clear that the potential abuses resulting from combinations under single control of both banking and nonbanking interests could easily exist in a case in which only one bank is involved. In fact, if the one-controlled bank were a large bank, the holding companies interests in extensive nonbanking businesses might very well lead to abuses even more serious than if the company controlled two or more very small banks.[2]

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[1]"Congenerics--Once Again," Golembe Associates, p. 2.

[2]U.S., Congress, House, Committee on Banking and Currency, Control and Regulation of Bank Holding Companies, Hearings, before a subcommittee of the Committee on Banking and Currency, House of Representatives, on H.R. 6227, 84th Cong., 1st sess., 1955, p. 15. The Patman Report specifically referred to the 1955 hearings, but made no reference to the 1956 hearings, in which the one bank exemption was again considered.

The above quotation is indicative of the underlying rationale of those who favored regulatory control over the one-bank holding companies. The difficulty with this contention was that the one-bank companies were not responsible for the major concern of those supporting the 1956 legislation, which was fear of a corporation's control of a large number of banks and, at the same time, of nonbanking activities.[1] So long as the corporation held only one bank, there was thought to be little possibility of the kind of concentration of economic power which was deemed to be inimical to the public interest. With respect to this issue, a 1956 report from the Senate Banking and Currency Committee contained the following observation:

> . . . Your committee did not deem it necessary to include . . . any company which manages or controls no more than a single bank. It is possible to conjure up visions of monopolistic control of banking in a given area through ownership of a single bank with many and widespread branches. However, . . . no present danger of such control through the bank holding company device threatens to a degree sufficient to warrant inclusion of such a company within the scope of this bill. *Should legislation of that nature prove desirable in the future, the Congress is free to act upon a showing of need for such a law.*[2] (Italics mine.)

The two-bank versus one-bank controversy was again subject to extensive examination and debate during congressional consideration of the 1966 amendments to the Bank Holding

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[1] J. L. Robertson, vice-chairman of the Board of Governors of the Federal Reserve System, private interview held on February 10, 1969. See *supra*, pp. 36-37.

[2] Quoted in William F. Upshaw, "Federal Regulation of Bank Holding Companies--II," *Federal Reserve Bank of Richmond Monthly Review*, November, 1968, p. 2.

Company Act. The arguments presented in favor of extending control to one-bank holding companies, like those in 1955, were centered around the potential abuse of economic power issue. The Federal Reserve Board, once again, attempted to persuade the Congress to bring the one-bank holding companies under federal regulation.

Congressman Charles E. Bennett of Florida agreed with the position taken by the Board of Governors of the Federal Reserve:

> We have announced a principle . . . in the 1933 law that a possibility of a conflict of interest is involved in having banking and nonbanking business held in the same hands. That is a sound idea. Another sound idea is that it creates monopoly . . . ; but the conflict of interest one and the monopoly one both run through all of these things, and there is no logical reason for exempting the one-bank provision. I realize it is the most controversial one, because there are many more banks involved, but as far as the virtue of it is concerned, it is just as clear as crystal. There is no argument I can see that denies it at all.[1]

The Independent Bankers Association of America was instrumental in leading the fight to leave the one-bank inclusion in existing legislation. Officials of the Association, in testimony given during the 1966 congressional hearings, stressed that the one-bank holding companies are not involved in the problem of expansion and concentration, that they were a useful device in preserving independent ownership of a small bank, that it was not aware of abuses which would justify the restriction of one-bank holding companies from nonbanking activities, and doubted that any solid evidence of such abuse

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[1]U.S., Congress, Senate, Committee on Banking and Currency, Bank Holding Company Act, Hearings, 1966, p. 57.

could be presented to the committee.[1] Their position, of course, was founded on the fact that, with few exceptions, one-bank holding companies are involved in the operation of small banks.

In the absence of concrete evidence of actual abuse of power by the one-bank holding companies, the Congress chose, in 1966, not to expand the scope of the regulatory legislation to include one-bank holding companies. It is opined that the reason for such action was based not only on this factor, but in large part on political expediency. The proliferation of small banks throughout the rural areas of the nation results in the exercise of significant influence over the constituencies of many congressmen by bankers. The hostility costs of including the one-bank holding companies, located in numerous small communities of the nation, in the federal regulatory process could be devastating to one who is dependent upon the favor of constituents to remain in office. To the puritan, the issue is "clear as crystal," but it must be remembered that crystal clear issues are more often than not "fogged" by the necessities of political realism.

In view of the extensive debates over a period of more than a decade regarding this issue, it seems clear that the Bank Holding Company Act "was written in its present form after careful deliberation with the express purpose of differentiating between corporations owning one bank and those owning

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[1] *Ibid.*, pp. 119-21. See *infra*, pp. 98-101.

more than one."[1] The "loophole" argument, in this context, simply is not supported. The writer prefers to refer to the exemption of one-bank holding companies from federal regulatory jurisdiction as an "intentional omission" rather than a "loophole" in banking legislation.

It is recognized that the semantics of the issue can lead to false conclusions. Because of the one bank exemption, it has been amply documented in the introductory chapter to this paper that the growth of unregistered bank holding companies has accelerated to alarming proportions. The question for the Congress to decide is whether or not the ultimate results of this growth are in the best interests of the nation, and if not, to enact corrective legislation.

Concentration of Economic Power

Undoubtedly, the greatest concern of many of those who view the rise of the one-bank holding company is the possibility that these institutions will be able to mass a degree of economic power that is decidedly contrary to the interest of the general public. The concern, of course, is predicated on the fact that there are no existing restrictions to prevent such companies from acquiring a large nonbanking industrial complex. Chairman Patman, of the House Committee on Banking and Currency, in a cover letter to the committee report on the growth of unregulated bank holding companies expressed conviction that the financial congeneric problem is broader than

[1] Association of Corporate Owners of One Bank, "General Platform," Washington, D.C., September 23, 1968, p. 1. (Mimeographed.)

the effective regulation of banking:

> . . . It concerns the proper relationship between the business of banking and all other businesses. It is not strictly a banking issue at all, or even an issue only involving the relationships among different segments of the financial community. It is, in essence, a question whose answer could shape the ultimate structure of the entire American economy for many years to come.[1]

Indeed, the committee report concludes that the one-bank holding company is a device the employment of which "could change the economic structure of the United States by the creation of giant conglomerate cartels centered around large banking institutions."[2]

The United States Department of the Treasury, in a synoptic review of the one-bank holding company development, prepared for the purpose of supporting its version of a bill to control the movement, expressed the same sentiment:

> While the vast majority of the new large bank-dominated OBHC's have expressed an intention to limit their activities to banking on financially related services . . . , there is a clear and present danger that bank acquisitions by industrial conglomerates could force a change in these intentions. Should this occur, it seems predictable that our economy could shift within the next 9 to 10 years from one in which economic power is rather widely dispersed into one dominated by 50 or so major power centers, each comprising a major industrial-financial complex.[3]

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[1] U.S., Congress, House, Committee on Banking and Currency, Unregistered Holding Companies, Patman Report, 1969, p. iii.

[2] Ibid., p. 2.

[3] U.S., Department of the Treasury, "Summary of the Background of Development of the One-Bank Holding Company Problem and a General Outline of the Principal Points To Be Included in a Legislative Resolution of this Problem," Washington, D.C., February 18, 1969, pp. 2-3. (Mimeographed.)

The fear of undue concentration of economic power accruing to the financial congenerics is discounted by its proponents. They maintain that "it is quite clear that banking itself is subject to the antitrust laws, but even if this were not the case, there is no exemption for a financial congeneric from the antitrust laws."[1]

The application of the antitrust laws to the possible abuse of power by one-bank holding companies has a twofold aspect: (1) restraining the exercise of undue economic power by conglomerates in control of banks, and (2) the restraint of such power by the financial congenerics. Both aspects certainly fall within the broad purview of the Sherman and Clayton antitrust acts which set forth the basic American policy regarding business enterprise, of which the chief objective is the maintenance of a free and competitive market.

Conglomerate mergers, of course, involve diversified companies that are neither direct competitors nor in a supplier-customer relationship. The Department of Justice foresees a possible danger from these types of mergers and it has been fairly explicit on the role which it intends to play. During May 1968, the Department issued guidelines concerning its standards for determining whether to oppose corporate acquisitions or mergers under Section 7 of the Clayton Act, including those leading to the formation of conglomerates. Of significance to the congeneric development is that the

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[1]Golembe, "Control of One-Bank Holding Companies," p. T-8.

Department will ordinarily challenge any market or product extension between one of the most likely entrants into the market and:

> (1) any firm with approximately 25 per cent or more of the market; (2) one of the two largest firms in a market in which the shares of the two largest firms amount to approximately 50 per cent or more; (3) one of the four largest firms in a market in which the shares of the eight largest firms amount to approximately 75 per cent or more, provided the merging firm's share of the market amounts to approximately 10 per cent or more; or (4) one of the eight largest firms in a market in which the shares of these firms amount to approximately 75 per cent or more, provided either (A) the merging firm's share of the market is not insubstantial and there are no more than one or two likely entrants into the market, or (B) the merging firm is a rapidly growing firm.[1]

These guidelines logically encompass the activities of one-bank holding companies and it is reiterated that they are applicable to merger by product extension as well as merger by market extension. With respect to these guidelines, a memorandum prepared for distribution within the banking industry by Carter H. Golembe Associates, Inc., emphasized that the Justice Department's

> policy . . . is stated as being to "prevent changes in market structure that appear likely over the course of time to cause a substantial lessening of competition that would otherwise exist to or to create a tendency toward monopoly." The Department goes on to point out that it will take a particularly hard look at those mergers which involve potential entrance into the market, the dangers of reciprocal buying, and those "which for one or more of several reasons threaten to entrench or enhance the market power of the acquired firm . . . ." Moreover, the <u>Guidelines</u> make it clear that the Department will not be restricted in dealings with conglomerate mergers to just those situations already described but would take action against any acquisition which "on specific analysis appears anti-competitive."[2]

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[1] Fischer, "Congenerics and the Clayton Act," p. 10.

[2] "Congenerics--Once Again," Golembe Associates, p. 6.

Richard W. McLaren, the new head of the Justice Department's Antitrust Division under the Nixon Administration, is in accord with these views. He has publicly stated that he prefers to use the present Clayton Antitrust Act against conglomerate mergers in restraint of competition before asking for new legislation. Also, with respect to the application of the antitrust laws to regulated industries, Mr. McLaren told the Senate Judiciary Committee that he endorses the larger role the Antitrust Division has taken in regulatory agency matters in recent years and that "promoting competition in regulated industries is consistent with President Nixon's position of reducing regulation."[1]

The most discussed theory under which the Clayton Act could be applied to conglomerate mergers or acquisitions holds that large companies which have the potential through internal expansion, to diversify into other products or services should be barred from acquiring a major company already engaged in such activities. The writer believes that the theory will be sustained. In fact, although the litigation was settled by consent judgment rather than judicial decree, there is a precedent case in support of this belief.[2] Another case, however,

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[1]"Nixon Antitrust Drive on Conglomerate Ties Is Indicated by Aide," Wall Street Journal, January 30, 1969, p. 19.

[2]First National City Bank of New York's acquisition of the Carte Blanche Corporation was challenged by the Department of Justice under its antitrust powers. The consent judgment was awarded in April, 1968, after First National sold its

involving the right of a bank which did no trust business (First National Bank of Hawaii) to acquire a trust company which limited its activity to the trust field apparently will be tried.[1] The outcome will have profound significance on the trend toward product proliferation by any large-scale enterprise, whether it be conglomerate or congeneric.

It is also apparent that the Nixon Administration, through the Department of the Treasury, although opting for federal control of the one-bank company corporate structure for the purposes of preventing an undue concentration of economic power by bank-dominated conglomerates, has not rejected the employment of the antitrust weapon to combat the problem. The Treasury believes that the amendments to the Bank Holding Company Act should include explicit language to the effect that

> the new legislation should in no way be implied as diluting the authority of the Justice Department in its antitrust enforcement under the Sherman and the Clayton Acts. . . . that any action by a Federal Banking Agency approving acquisition by a registered bank holding company shall in no sense be viewed as estopping antitrust action by the Justice Department.[2]

Some digression is in order. The banking industry is faced with a dilemma. If banks, in accordance with favorable rulings by the regulatory agencies, act to diversity their

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Carte Blanche stock. The bank has since formed a one-bank holding company. Fisher, "Congenerics and the Clayton Act," p. 3.

[1] Ibid.

[2] U.S., Department of the Treasury, "One-Bank Holding Problem," p. 5.

products and services or to extend their markets, they may at some later date be forced to justify such action in the courts. If fear of the ultimate economic costs, with the attendant publicity of possible antitrust action, unduly influences a bank's decision to refrain from product or market extension, both the public and the bank's stockholders are denied the benefits to be accrued by the increased activity.

Relative to the antitrust-regulatory agency dichotomy is the concern of those in the banking industry who view as unnecessarily discriminatory the exposure of one-bank holding companies to the restrictions of both the antitrust laws and the considerable body of administrative law imposed by the regulatory agencies. Indeed, the First Pennsylvania Banking and Trust Company, Philadelphia's largest bank, maintains that the imposition of regulatory controls over one-bank holding companies and not over industrial conglomerates "would be a slap against the banking profession."[1]

Returning to the issue under consideration, the Patman Report is especially critical of the potential consequences the growth of unregistered bank holding companies may have on the economic structure of this nation. It expressed concern that these companies have the potential to discriminate unfairly against the users of bank credit by denying credit to a qualified applicant who is a competitor of a bank's subsidiary, or to insist that the applicant agree to use the services

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[1]"Bankers Board Congeneric Bandwagon," Savings and Loan News, January, 1969, p. 37.

of the bank's fellow subsidiaries if he wants continued access to bank credit. The report logically concluded that such practices would be "unfairly competitive against non-bank related competitors of these subsidiaries and in the long run could substantially reduce or eliminate competition in many businesses to the detriment of the public interest."[1]

These activities are known as "tie-in" or "self-dealing" arrangements and are antithetical to the objectives of American antitrust policy. They can serve no purpose but to suppress competition. Section 1 of the Sherman Act clearly stipulates that: "Every contract, combination . . . or conspiracy, in restraint of trade or commerce . . . among the states . . . is declared illegal."[2] Section 2 of the act also makes it clear that those who "monopolize, or attempt to monopolize, . . . any part of the trade or commerce among the states . . . shall be deemed guilty of a misdemeanor."[3] Supreme Court decisions in antitrust cases have clearly established that such self-dealing agreements are: (1) unreasonable *per se* violations of the Sherman Act, (2) not limited to patent or copyrights, and (3) illegal whether or not specific intent to restrain trade or create a monopoly existed.[4]

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[1]U.S., Congress, House, Committee on Banking and Currency, *Unregistered Holding Companies*, Patman Report, 1969, p. 2.

[2]Antitrust Act (Sherman Act), *Statutes at Large*, XXVI, ch. 647 (1890), *U.S. Code*, Vol. III, Title 15, sec. 1 (1964).

[3]*Ibid.*, sec. 2.

[4]Associated Press v. U.S., 326 Wyatt (U.S.), 1 (1945); International Salt Co., Inc., v. U.S., 332 Wyatt (U.S.), 392 (1947); U.S. v. Griffith, 334 Wyatt (U.S.) 100 (1948).

Some may argue that, since banking is a service industry, the police of such practices in banking is not within the purview of antitrust jurisdiction. Proponents of this position refer to a 1953 Supreme Court decision which held that a service industry is not subject to Section 1 of the Sherman Act.[1] The Supreme Court, in 1958, however, abrogated the earlier decision.[2] A railroad was successfully challenged by the Justice Department for requiring the shipment of all commodities, which were grown on land leased or sold by the railroad, to be shipped via the railroad's transportation facilities.

During the past decade, the banking industry, itself, has been well exposed to antitrust litigation. In the Philadelphia case, the Supreme Court proclaimed:

> . . . we reject the position that commercial banking . . . because it deals in the intangibles of credit and service rather than in the manufacture or sale of tangible commodities is somehow immune from the anticompetitive effects of undue concentration.[3]

Further, the specific precedent for prosecution against a bank's use of a tie-in contract was established in 1965.[4] The issue

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[1]Times Picayune Publishing Co., v. U.S., 345 Wyatt (U.S.), 594 (1953).

[2]Northern Pacific Railway Co., v. U.S., 356 Wyatt (U.S.), 1 (1958).

[3]U.S. v. Philadelphia National Bank, 374 Wyatt (U.S.), 321 (1963).

[4]Bank of Utah, Inc., v. Commercial Security Bank, Inc., U.S. Dist. Ct., Utah, Cen. Div., No. C66-64, C.C.H. Trade Cases, par. 71,540 (1965). This case followed successful application of the Sherman Act by the Justice Department against interest rates and check service charges agreements by banks in New Jersey and Minnesota. See: U.S. v. Hunterdon Trust Co.,

at bar was whether or not a "no-check contract" between a manufacturer and a bank, which was let by the manufacturer to the highest bidder, constituted a tie-in arrangement in violation of Section 1 of the Sherman Act. Notwithstanding that the Court, by consent judgment, declared that the contract did not constitute a tie-in arrangement, the importance of the case is that it was not denied or refuted by the bank or the Court that a tie-in contract by a bank was not subject to antitrust jurisdiction.

It has been amply demonstrated in this study that, by precedent action and future intention on the part of the federal government, the banking industry has been and will continue to be subject to the application of the antitrust laws. Although the Patman Report makes no reference to these laws, it seems clear that they render illegal the possible abuses of power of which the report complains.

This writer is in accord with those who contend that the antitrust laws can be used to combat the undue concentration and abuse of power by unscrupulous operators of the financial congenerics and/or the conglomerate organizations. He agrees with those who maintain that the anticompetitive aspects of a concentration of alternative sources of credit under common control is a proper focus of concern and should

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et al., U.S. Dist. Ct., N.J., Civ. No. 1100-61, C.C.H. Trade Cases, par. 70,263 (1962); U.S. v. The First Nat'l Bank, St. Paul, et al., U.S. Dist. Ct., Minn., 3d Div., No. 3-63, Civ. 37, C.C.H. Trade Cases, par. 71,021 (1964); and U.S. v. Duluth Clearing House Assn., et al., U.S. Dist. Ct., Minn., 5th Div., No. 5-63, Civ. 4, C.C.H. Trade Cases, par. 71,022 (1964).

be looked into by both the regulatory agencies and the Justice Department. He is not so naive, though, as to agree that the present application of the antitrust laws are capable of completely preventing the emergence of monopolistic or near-monopolistic forces in the financial markets. The enforcement of the antitrust policy, by historical precedent and sheer complexity of application, remains generally more a matter of policing after the fact than before the fact. Perhaps the major drawback to the enforcement of antitrust policy is that prosecutions under the Sherman Act are discretionary, not mandatory; hence, they are subject to the pressures inherent in the political process. It is believed, however, that once the government's policy of enforcing the provisions of the antitrust laws against the financial congenerics is fully enunciated and has been successfully tested in the courts, the congenerics, for economic reasons alone, will bend every effort not to run afoul of these laws.[1]

One final aspect of the possible concentration of undue economic power by the one-bank holding companies must be considered. In the following section of this chapter it is emphasized that, due to a provision of the Federal Reserve Act, a bank's solvency and liquidity is not threatened by the extension of credit by the bank to its parent unit or fellow

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[1]Any person who is injured by reason of anything forbidden in the antitrust laws can recover triple damages plus the cost of the litigation and a reasonable attorney's fee. U.S. Code, Vol. III, Title 15, sec. 15 (1964).

subsidiaries.[1] It is maintained, however, by the opponents of the congeneric development that, when the size of the banks who have opted to form a one-bank holding company is considered, this restriction is not sufficient to preclude the extension of extremely large credit grants at the lower end of the authorized interest rate schedule by a large bank to its corporate affiliates, thereby greatly enabling the growth of such affiliates as opposed to their competitors.[2]

At first blush, there appears to be no rebuttal to this contention. Another clause in 12 U.S.C. 371c, however, lends credence to the position taken by the proponents of the financial congenerics that such large loans would not be effected:

> . . . each loan or extension of credit of any kind or character to an affiliate shall be secured by collateral in the form of stocks, bonds, debentures, or other such obligations having a market value at the time of making the loan or extension of credit of at least 20 per cent more than the amount of the loan or extension of credit.

In essence, the provision requires that any loan granted by a bank to its affiliate must be collateralized at 120 per cent. It was pointed out to this writer that: (1) it is economic folly for any enterprise to collateralize a loan at 120 per cent; and (2) if an affiliate is able to give that kind of collateral (with respect to the magnitude of the loans

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[1] Federal Reserve Act, Statutes at Large, XXXVIII, ch. 6, sec. 23(a) (1913), U.S. Code, Vol. III, Title 12, sec. 371(c) (1964). See infra, pp. 109-10.

[2] First National City Bank of New York and Bank of America of San Francisco have capital and surplus exceeding one billion dollars; hence, such lending could be substantial.

in question), it does not need the loan to finance increased growth, as it would be able to generate capital requirements within its own internal resources.[1]

The writer is in agreement with this position. It must, however, be conceded that the management of a small or "infant" financial congeneric could be willing to collateralize a loan at 120 per cent in order to acquire low-cost credit for the expansion of its present operations or for diversification purposes. The effect of such activity, however, would be the furtherance of competition, not the restriction of competition, therefore, not inimical to the public welfare. Any enterprise has the right to grow and prosper and to expend every legal effort toward furthering that right. Growth is the hope and goal of all progressive business managements, and, as long as such growth is not in violation of the public interest, whereby it results in the creation of a monopolistic enterprise or the tendency to become a monopolistic enterprise, such growth should not be discouraged.

Protection of Bank Depositors

It was mentioned in Chapter Two that, historically, a primary congressional purpose behind the authorization of bank regulatory legislation has been the protection of the public interest by securing the safety and soundness of banks. It follows that banks are regulated and controlled in the scope of

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[1]Private interview held on February 18, 1969, with the Washington representative of a large bank corporation. (The contributor requested not to be publicly identified.)

their activities to protect the public against the consequences of bank failure.

The Banking Acts of 1933 and 1935 have been generally regarded as a determination on the part of Congress to segregate and limit the activities of commercial banks. A careful review of the history of these acts will reveal that:

> . . . Nothing could be further from the truth. The banking legislation of the early 1930's fitted precisely into the pre-existing concept of legislation to protect the banks, and by protecting the banks to protect the public the banks served, rather than to stultify their development. The divorce of commercial banking from the securities business was intended to protect the public, not to deprive the public of freedom of choice in the provision of services. It was designed to protect the bank and not protect the securities dealers.[1]

If the congressional purpose was not to specifically segregate and limit the activities of commercial banks, it follows, with regard to the safety of bank deposits, that evaluation of the need for additional control over one-bank holding companies should be made in terms of whether or not the particular activities of these organizations unduly add to the risks taken by banks. The relevant question is whether the one-bank holding company development makes it more difficult for bank regulatory agencies to protect the public against the consequences of bank failure. The advocates of the congeneric development claim:

> The bank which becomes part of a financial congeneric in no way insulates itself from the full weight of bank regulation as it has been developed over a century and a half. No present limitation on the operation of the bank

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[1] Harfield, "Propriety of Expanding Bank Services," p. 564.

> is altered, no standard is changed, no visitorial right by supervisory authorities is diminished.[1]
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> . . . We recognize that the public interest requires both the protection of bank depositors and the fullest possible service to the public. . . . We submit that existing legislation is fully adequate to achieve both. . . . present powers available to bank regulatory agencies are adequate to insure that bank operations are conducted in a safe and sound manner. . . . In short, the authority of the bank regulatory bodies is complete and compelling. . . . Corporations owning one bank are also subject to regulation by numerous state and federal agencies who provide the traditional government safeguards against conflict of interest and self-dealing.[2]

These claims bear investigation. They can not stand unchallenged, a challenge which involves a review of certain federal statutes in Title 12 of the United States Code which are applicable to the supervision of banking practices and activities.[3]

There can be no question that a bank, whether an independent unit, a subsidiary of a registered bank holding company, or a component of a one-bank holding company, is subject to the diverse, powerful and comprehensive controls by the various federal and state regulatory agencies. The discourse to follow, therefore, will be limited to a discussion concerning the adequacy of existing legislation to protect bank depositors from a possible abuse of power by the operators of financial congenerics.

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[1]Golembe, "Control of One-Bank Holding Companies," p. 13.

[2]Association of Corporate Owners of One-Bank, "General Platform," p. 2.

[3]These are: 12 U.S.C. 221a, 12 U.S.C. 481, 12 U.S.C. 371c, and Titles II and III of the Financial Institutions Supervisory Act of 1966.

Title 12 U.S.C. 221a defines the term "holding company affiliate" to be:

> . . . any trust, association, or other similar organization which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of any one bank at the preceding election, or controls in any manner the election of a majority of the directors of any one bank. (Italics mine.)

Title 12 U.S.C. 481 grants to the Comptroller of the Currency the power to appoint bank examiners to:

> . . . make a thorough examination of all the affairs of the [national[bank . . . and [submit] a fill and detailed report of the condition of said bank to the Comptroller of the Currency: Provided; That in making the examination . . . the examiners shall include such an examination of the affairs of all its affiliates other than member banks as shall be deemed necessary to disclose fully the relations between such bank and such affiliates and the effect of such relations upon the affairs of such bank; and in the event of the refusal to give any information of any such affiliate, or in the event of the refusal to permit such examination, all the rights, privileges, and franchises of the bank shall be subject to forfeiture. (Italics mine.)

The language of 12 U.S.C. 221a renders obvious the conclusion that the parent unit of a bank within the one-bank holding company structure would be an affiliate of a national bank and therefore subject to the bank examining provisions of 12 U.S.C. 481. With respect to the nonmember banks and member banks, similar powers are respectively conferred upon the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System.[1] Certain other provisions of 12 U.S.C. 481 are indicative of the extensive powers the

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[1] U.S. Code, Vol. III, Title 12, secs. 483, 1820(b) (1964).

federal regulatory agencies may exercise in the examination of the records and activities of a bank's affiliates: The bank examiner is authorized to administer oaths to the officers, directors and employees of the affiliate; the expenses of the examination are borne by the affiliate; and the Comptroller is authorized to cause the publication of the results of the examination of the bank or the affiliate.

The provision which provides for administrative action to disenfranchise the bank of an affiliate that refuses to give the bank examiner pertinent information or to submit to examination is a powerful weapon in the hands of the regulatory agencies.[1] It is opined that this provision, alone, is sufficient to cause the financial congenerics, which by their very nature are dependent upon a viable banking subsidiary, not to antagonize the regulatory agencies by such refusals or by engaging in activities which would be considered as inconsistent with the competitive posture and solvency of the bank which it controls.

In the consideration of the approval of a loan, it is conceivable that a financial congeneric could, by virtue of an abuse of economic power, subordinate the public interest to the conflicting interests of corporate subsidiaries. Of equal importance, however, is the concern that the bank will favor its own affiliates with loans at lower interest rates or better

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[1]The subsidiary bank is also subject to a penalty of not more than 100 dollars for each day that such refusal continues. This is considered a substantial detriment to the more traditional one-bank holding companies. With respect to the highly capitalized banks, it is of minor importance.

lines of credit than those available to the affiliates' competitors, or even worse, that the grant of loans to its own affiliates will endanger the solvency of the bank. There is a twofold implication: (1) the accretion of massive economic power by the operators of the financial congenerics;[1] and (2) the risk of bank failure due to imprudent and excessive loans to the bank's parent or fellow subsidiaries. The second implication is pertinent to the protection of bank depositors and, therefore, submitted for discussion at this time.

Under the provisions of 12 U.S.C. §371c, the federal bank supervisory agencies are granted the authority to oversee and control the conditions by which loans may be granted between banks and their corporate affiliates. The statute stipulates that:

> . . . No member bank [an insured bank, national or state] shall (1) make any loan or any extension of credit to, or purchase securities, under repurchase agreements from *any* of its affiliates, or (2) invest any of its funds in the capital stock, bonds, debentures, or other such obligations of any such affiliate, or (3) accept the capital stock, . . . as collateral security for advances made to any person, partnership, association, or corporation, if in the case of *any* such affiliate, the aggregate amount of such loans, . . . will exceed 10 per centum of the capital stock and surplus of such member bank, or if, in the case of *all* such affiliates, the aggregate amount of such loans, . . . will exceed 20 per centum of the capital stock and surplus of such member bank. (Italics mine.)

The statute obviously serves to protect the interests of bank depositors by preventing excessive concentration of a bank's extended credit within its own corporate jacket. Reduced to simple terms, it forbids a bank from making secured

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[1]See *supra*, p. 92.

loans in excess of 10 per cent of the capital and surplus to a single affiliate, nor in any case, in excess of 20 per cent of said capital and surplus to all affiliates together. It is difficult to foresee how the solvency of a bank could be endangered by the effect of intercorporate loans, when the aggregate restriction of the amount of such loans leaves 80 per cent of a bank's capital and surplus free for alternative investment sources external to the bank's corporate structure.

As recently as 1966, the federal banking agencies were granted substantial powers to take proper action in any case in which they believe the solvency or the liquidity of a bank is in jeopardy. The legislation defines what is an "appropriate banking agency" and authorizes such agencies to issue cease-and-desist orders to any bank or its affiliate which, in the agency's opinion, is engaging, or is about to engage, in unsafe or unsound practices. It further authorized the issuance of such orders to estop a violation or prevent a violation of any "law, rule, or regulation, or any condition [italics mine] imposed in writing by the agency in connection with the granting of any application, or any written agreement" entered into by the bank with the agency. In case of failure to obey such an order, the agency may apply to the applicable United States District Court for an injunction to enforce compliance, and if the court determines that there has been a violation, the court must issue the injunction.[1]

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[1] Financial Institutions Supervisory Act, Statutes at Large, LXXX, Pub. L. 89-695, secs. 202, 303 (1966).

The act authorizes the imposition of a severe penalty against banking officials who have engaged in practices in violation of the public trust and confidence. The appropriate banking agency may, after due notice and hearing, suspend and/or prohibit any bank director or officer from further participation in the affairs of the bank, who

> by conduct or practice with respect to another insured bank or _other institution_ which resulted in substantial financial loss or other damage, has evidenced his personal dishonesty and unfitness to continue as a director or officer and/or has evidenced his personal dishonesty and unfitness to continue in the conduct of the affairs of such bank. (Italics mine.)[1]

It is emphasized that the act not only permits an agency to issue cease-and-desist orders relative to a bank's internal operations, but also to issue such orders with respect to its operations with other institutions. This provision is viewed as a powerful means of overseeing the activities of the one-bank holding companies. For example: The Comptroller of the Currency, by causing the insertion of the following _condition_ in every communication with a bank wherein said bank's request to form a one-bank holding company is approved, has found an effective means of controlling their activities:

> It should be understood that neither the continuing bank, its parent corporation, nor any subsidiary of its parent corporation may organize or acquire any incorporated or unincorporated business without the prior approval of this office.[2]

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[1] _Ibid._, sec. 202.

[2] Quoted from a copy of a Treasury Department letter of January 8, 1969. (The writer is not at liberty to reveal the source of this information.)

It is emphasized that the prior approval condition is applicable to the acquisitions of unincorporated as well as incorporated businesses by any component part of the one-bank holding company structure. It is with the use of this conditional clause and the cease-and-desist powers granted by the Financial Supervisory Act, that the Comptroller is able to exact compliance with his rulings as to the kinds of business activities national banks and their affiliates may be engaged. In view of the Comptroller's power to disenfranchise a recalcitrant bank, as well as to issue cease-and-desist orders, it is not considered likely that the financial congenerics will act in contravention of the Comptroller's desires.

There exists, however, a serious flaw in this procedure. The Comptroller, in furthering the diversification desires of the national banks, has authorized said banks to engage in activities which have been challenged as not being in accord with the historical provisions and purposes of banking legislation. In effect, the Comptroller has been charged with the usurpation of the legislative function by an abuse of his power to create administrative law.[1]

In view of the foregoing analysis, it is difficult to deny that present legislation does not provide the regulatory tools for the protection of bank depositors. There is, however, a practical consideration. The possession of the power to act, and the implementation of that power are representative of "two different sides of a coin." The

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[1]See *supra*, pp. 75-76.

implementation of public policy is often far more difficult than the processes by which that policy is formulated.

The administration of the examinations and reports systems required by the three banking supervisory agencies is exercised within a complex system of interagency control, coordination and responsibility. More often than not, an agency will accept the reports of one of the other two agencies rather than conduct its own examination of a bank.[1]

Traditionally, the examining stress has been toward the bank, itself. The emergence of the financial congeneric demands that increased emphasis be placed on the examination of the bank's affiliates. It has been emphasized by a prominent official in the banking community that some banking agencies will need to develop a higher degree of accounting sophistication if they are to be able to consistently determine that the interests of depositors are adequately protected.

Indeed, the eminent general counsel for the American Bankers Association, Mr. Matthew Hale, expressed the opinion that, although present legislation provides the powers to protect bank depositors from a possible abuse of power by the financial congenerics, the implementation of the machinery to guarantee effective application of said powers has not been fully accomplished. He expressed serious reservations about the ability of the agencies to ever achieve a degree of efficiency sufficient to ferret out, in every instance, the acts by bankers and their affiliates which may be detrimental

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[1]See *supra*, pp. 32-33.

to the public interest. To illustrate his point, he cited the failure of government examiners to uncover the unethical practices of Don Silverthorne, a banker in San Francisco in 1967, the result of which was the failure of his bank.[1]

In consideration of the foregoing discussion, it is apparent that the rise of the financial congenerics does impose an additional regulatory burden on the bank supervisory agencies. It is equally apparent that the agencies have adequate grants of power which, if properly exercised, will enable them to safeguard the public interest against any potential abuse of power by these organizations. The question to be resolved by the Administration and the Congress is whether to expend the requisite funds and energy to create a viable and workable process of examination and constraint of the activities of both banks and their affiliates through the efficient implementation of existing grants of power to the federal regulatory agencies, or to take a more simple, but historically reactionary, approach and control the financial congeneric's activities by enacting specific and restrictive banking legislation.

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[1]Matthew Hale, private interview held on January 8, 1969.

CHAPTER V

POSITIONS OF GOVERNMENT AND PRIVATE INTERESTS

It is virtually a certainty that legislation will be passed this year by Congress to effect some measure of control over the activities of one-bank holding companies. Legislative proposals for this purpose have been introduced by the Administration and by members of both Houses of Congress. The drafts of these proposals reveal sharply defined contrasts as to the extent and direction of the control to be imposed. The final legislation will necessarily reflect a balance of the opposing factions and exemplifies the method by which basic policy is formulated in this country. "Conditions are the controlling force, they give rise to interests. The interests have access to political forum. In that forum the policy of the nation is determined."[1] This chapter is devoted to an analysis of the proposed legislation and to the identification of the viewpoints or positions of the major forces, both government and private, that are acting to influence national policy.

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[1]Redford, American Government and the Economy, p. 479.

The Legislative Proposals

The Patman Bill

Congressman Wright Patman, chairman of the House Committee on Banking and Currency, on February 17, 1969, introduced a bill to bring one-bank holding companies under federal regulatory control.[1] His stated purpose was to "end the movements of banks into nonbanking enterprises."[2] This purpose is consistent with his prior convictions:

> The issue is a fairly simple and very fundamental one, and in the 1930's Congress emphatically decided that the health of the American economy depended in large part on keeping the business of banking separate from all other businesses. The history, background and development of the circumstances surrounding this issue, however, are not so simple. It took 20 years to obtain enactment of the Bank Holding Company Act of 1956. . . . this piece of landmark legislation, . . . [has] many weaknesses and loopholes. . . . we can wait no longer to consider amending legislation to plug these loopholes.[3]

Analysis of the Patman proposal clearly shows that it is the congressman's intention to subject one-bank holding companies to the same stiff restrictions which govern multi-bank holding companies. It is also clear that certain provisions of his proposal extend into areas not directly related to the one-bank holding company problem. The essential features of the Patman bill are that: (1) One-bank holding companies would be required to register with the Federal

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[1]H.R. 6778, 91st Cong., 1st sess. (1969).

[2]"Reserve Unit to Bank Some Easing of Curbs on Bank Holding Firms' Nonbanking Plans," Wall Street Journal, February 17, 1969, p. 4.

[3]U.S., Congress, House, Committee on Banking and Currency, Unregistered Holding Companies, Patman Report, 1969, p. iii.

Reserve Board under the Bank Holding Company Act. (2) Proposed acquisitions by one-bank holding companies would be subject to approval by the Federal Reserve under guidelines already established by the Board for acquisitions by other registered holding companies. (3) One-bank holding companies, existing or proposed, would have to divest themselves within five years of any affiliate whose business is, as determined by the Board, not so closely related to the banking business as to be a proper incident thereof. (4) "Control" would be redefined to include situations where the Federal Reserve finds stock ownership is less than 25 per cent but where "actual control" exists. (5) Partnerships in control of one or more banks would be required to register with the Federal Reserve Board and be subject to the provisions of the Bank Holding Company Act. (6) Tie-in and self-dealing arrangements, relative to the business transactions of bank holding companies and their affiliates, would be specifically prohibited. (7) Personnel in the financial community would be prohibited from being an officer or director of more than one financial institution.

The Proxmire Bill

Following closely on the heels of the Patman bill, Senator William Proxmire, chairman of the Senate Banking and Currency Committee's subcommittee on Financial Institutions, on February 19, 1969, also introduced a bill which would subject one-bank holding companies to the regulatory

provisions of the Bank Holding Company Act.[1] Other than omitting references to interlocking directorships and to tie-in and self-dealing arrangements, the bill is essentially the same as the Patman proposal. There is, however, one major difference.

The Patman bill, as noted above, would require divestiture of the activities of existing or proposed one-bank holding companies which are presently deemed to be not related to banking. The Proxmire bill would not require immediate divestiture, but would permit continued operation of all such activities which existed as of January 1, 1969, pending the completion of a report on banking structure by a proposed Presidential commission which the bill would establish.

The Administration Bill

The Nixon Administration is also on record for providing federal regulation over the activities of one-bank holding companies. On March 24, 1969, Senator Wallace Bennett introduced the Administration's proposal to the Congress.[2]

Analysis of the Administration's bill reveals that it and the two proposals previously cited are in agreement on the need for subjecting the activities of one-bank holding companies to federal regulation; however, there is major disagreement as to the extent and direction of this control.[3]

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[1]S. 1052, 91st Cong., 1st sess. (1969).

[2]S. 1664, 91st Cong., 1st sess. (1969).

[3]All three proposals are in agreement that partnerships should be included within the purview of the Bank Holding

The important areas of legislative discord between the congressional proposals and the one offered by the Administration are: (1) The Patman and Proxmire bills would vest jurisdiction in the Federal Reserve Board, whereas the Administration favors spreading regulatory authority among the three bank supervisory agencies along traditional lines--the Comptroller of the Currency for national banks, and the Federal Deposit Insurance Corporation for insured nonmember banks. (2) The Patman and Proxmire bills would restrict unrelated activities of registered bank-holding companies to the terms of the present Bank Holding Company Act, whereas the Administration favors a more liberal approach in which a three-member interagency council may determine, by unanimous agreement, a list of accepted categories of specific businesses in which bank holding companies may engage. (3) The Patman bill requires divestiture of unrelated activities, and the Proxmire bill would freeze such activities as of January 1, 1969, whereas the Administration proposal would provide a "grandfather clause" with an effective date of June 30, 1968.[1]

Company Act, and, that "control" of a bank by a holding company should be redefined. The Administration bill, like the Patman proposal, prohibits tie-in arrangements. It does not provide for restrictions against interlocking directorships.

[1]Existing or proposed one-bank holding company structures operative prior to the effective date of the "grandfather clause" would be left undisturbed, with no divestitures required. All acquisitions by any bank holding company after the effective date, however, would require approval of the appropriate supervisory agency and this approval would have to be consistent with the "accepted categories" as determined by the interagency council.

Two additional features of the Administration's proposal are worthy of mention. One is that it provides for the Federal Reserve Board to continue to be the sole regulator with respect to bank acquisitions by multi-bank holding companies, but not to financially-related nonbank acquisitions by those companies. The latter would be dispersed among the three agencies along the jurisdictional lines outlined above. The second is that it provides, with respect to financially-oriented activities, equitable treatment for the banks themselves. The activities which the interagency council deems acceptable for the subsidiaries of bank holding companies to be engaged in would also be acceptable activities for individual banks or their subsidiaries.[1]

Conclusions, derived from a comparison of the two basic legislative proposals,[2] are obvious. The Patman bill is in keeping with the historical precedents of banking legislation. It is reactionary. It would effectively end the surging growth in the number of one-bank holding companies without having made allowance for the root causes which precipitated that growth. Additionally, the Patman bill, because of the provision which prohibits service as an officer and director of more than one financial institution, projects itself into areas not limited to the one-bank holding company problem. In

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[1] This provision would be implemented by amendment to the incidental powers clause of the National Bank Act (12 U.S.C. 24 [Seventh]). See *supra*, pp. 62-66.

[2] Due to their inherent similarity, hereafter, unless specific differentiation is necessary, reference to the Patman bill is meant to include the Proxmire bill.

some respects it is an omnibus bill, one that, if enacted in its present form, will have a significant impact on the structure of American banking. The registration of all 875 existing or proposed one-bank holding companies under the supervisory authority of the Federal Reserve, compulsory divestiture of established business interests, inclusions of partnerships under regulatory control, together with the prohibition against interlocking directorships, all lend credence to this contention.

As seen in the preceding chapter, both the Administration and the Congress are concerned over a possible future concentration of power by major industrial-financial complexes if the one-bank holding company development is permitted continued growth in an uncontrolled environment. The Administration's proposal, as opposed to the Patman bill, is viewed as one of reaction and action. It is reactionary in that it also would extend federal control over the activities of one-bank holding companies. Its recommendation that an interagency council should be established to determine acceptable categories of activities for bank holding companies is viewed as both active and reactive responses to the problem: reactive, because it will effectively restrict the further expansion of conglomerate organizations into the banking structure; and active, because it is an explicit recognition that the banking industry must be responsive to changes in the economic environment. The provisions for equitable treatment for banks that are not affiliated with holding companies is further evidence

of the progressive attitude reflected by the Administration's proposal. Essentially, the Administration's bill is "confined to the issues and will have minimum impact on the existing structure of banking. It is aimed at the preservation of that structure."[1]

The Negotiated Consensus

The Administration's proposal reflects the diligent effort of Charls E. Walker, Undersecretary of the Treasury, to obtain, relative to the provisions to be included in the Administration's proposed legislation, a "negotiated-consensus" between the Administration, the federal supervisory agencies, and the banking trade associations, and thereby present "a united industry-government front" on a sensitive issue.[2] One authority on the subject has written:

> The major credit or blame--depending on one's outlook--must go to Treasury Undersecretary Walker. Motivated by a sincere belief in the need for appropriate legislation, the Undersecretary has labored tirelessly, using every bit of his abundant skill and persuasive powers, to cajole, persuade, or compel the banking agencies and the various bank and nonbank groups to fall in behind a proposal which, while perhaps not entirely satisfactory to any single group, is nevertheless acceptable in part to all.[3]

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[1] Charls E. Walker, Undersecretary of the Treasury, U.S. Department of the Treasury, private interview held February 24, 1969.

[2] "Nixon Will Propose Plan to Control 1-Bank Holding Firms," American Banker, February 7, 1969, p. 10.

[3] "One Bank Holding Companies--End of the Road?" (monthly memorandum prepared for distribution to clients of Carter H. Golembe, Associates, Inc., Washington, D.C., February, 1969), p. 4.

Indeed, Undersecretary Walker informed this writer that the Administration's package "does not satisfy everyone 100 per cent, but they can live with it."[1]

Industry Participation

American Bankers Association

The American Bankers Association functions as a trade association for the entire banking industry. In furthering the aims of that industry, it maintains a sizable permanent staff of specialists in various fields of banking.[2] It is committed to the maintenance of a viable and dynamic banking system:

> If one were to select a single policy goal to the attainment of which every effort should be directed, . . . it would be to preserve the ability of the banking industry to serve in every possible fashion the needs of our burgeoning economic system. We must guard against attempts . . . to circumscribe or vitiate the vitality and dynamism which is inherent in our banking system. The future for American banking is bright indeed, but it will remain that way only if we pay close attention to the development of the present day.[3]

Pursuant to this goal, the Association has played an important and significant unifying role in the development of the industry's position on a legislative approach to the one-bank holding company development.

During November, 1968, officials of the Association met with representatives of the Association of Corporate Owners of

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[1] Charls E. Walker, private interview held on February 24, 1969.

[2] Jules I. Bogen, Financial Handbook (New York: The Ronald Press Company, 1964), p. 2.33.

[3] Willis W. Alexander, "The Future Is Bright Indeed," Banking, LXI (January, 1969), 23. (Mr. Alexander is president of the American Bankers Association.)

One Bank, The Association of Registered Bank Holding Companies, the Independent Bankers Association of America, and other smaller bank organizations for a general discussion about the conceptual aspects and political problems posed by the emergence of the financial congeneric corporate entity. The purpose of the discussion was "to build a foundation for evolving a position acceptable to all segments of the banking community, [a position] manifested by industry-wide support for a bill which clarifies the role of the new companies [financial congenerics] in contemporary banking."[1] Indeed, the conferees were urged not to adopt hasty proposals and get themselves "locked-in" with untenable positions.[2]

The American Bankers Association will undoubtedly support the Administration's proposal. Its legislative provisions are definitely aligned with the aims of the Association--specifically, the maintenance of a dynamic industry protected from encroachment by non-financial enterprises.

Independent Bankers Association of America

The Independent Bankers Association of America is a trade group which represents the interests of some 6,500 small bankers. Its philosophical bent is forcefully proclaimed:

> We believe in the Independent Bank as keystone of the independent town and city. We view with alarm trends in

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[1]"ABA Sets Talks Nov. 20 to Seek Consensus on Govt. Regulation of 1-Bank Holding Units," American Banker, October 25, 1968, p. 8.

[2]Matthew Hale, general counsel for the American Bankers Association, private interview held on January 8, 1969.

> banking that would replace our American system of Independent Banks with the branches of big city, money market institutions. We are distressed and disturbed at the assumption that bigness, branches, concentration of banking power and elimination of the locally-owned Independent Bank are "progress."
>
> This is our Reaffirmation of truth. The locally owned, locally managed, locally responsive, locally oriented Independent Bank plays an essential and dynamic role in the independent American community. We are dedicated to this Truth of Independent Banking. We are dedicated to demonstrating its validity and value![1]

The Association is adamantly opposed to branch banking, finds its strength in those states wherein branch banking is not permitted, and is committed to the principle of "competitive equality" between state and nationally chartered banks.[2] Since some 10 per cent of its members' banks are components of the traditional one-bank holding company structure, it has constistently opposed the federal regulation of one-bank holding companies.[3] The rise of the financial congenerics is viewed by the Association, however, "as potential devices for concentrating the power of big banks in competition against community banks."[4]

Officers of the Association have told this writer that the Association will support the Administration's proposal.

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[1]"An Independent Bankers Credo," published in "1968-1969 Membership List," Independent Bankers Association of America, p. 122.

[2]E. Meyer Harris, First Vice President, Independent Bankers Association of America, private interview held on February 7, 1969.

[3]"IBAA Seeks to Hinder Big 1-Bank Holding Cos., Help Little Ones," American Banker, Oct. 3, 1968, p. 7. See supra, p. 90.

[4]Ibid. (The article quoted Ralph L. Baum, former chairman of the IBAA Federal Legislative Committee.)

This posture is predicated on the position taken by the Administration with respect to providing a "grandfather clause" for existing one-bank holding companies and to restricting the nonbanking activities of one-bank holding companies to financially related enterprises.[1] The essence of the Association's position is that it seeks the preservation of the corporate structures of its existing members, and, by favoring regulatory control over the financial congenerics, it accedes to the prohibition of future nonbanking acquisitions by its members.

Association of Registered Bank Holding Companies

The Association of Registered Bank Holding Companies will support the Administration's legislative recommendations.[2] These recommendations virtually encompass the principles expressed by the trade organization in its October 27, 1968, statement to the Board of Governors of the Federal Reserve System, a statement which set forth the need for liberal identification of the activities related to the banking industry and for equitable treatment under the law to engage in such activities.[3]

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[1] C. Herchel Schooley, Manager, Washington, D.C., Office, Independent Bankers Association of America, private interview held on February 7, 1969.

[2] Donald L. Rogers, Executive Director, Association of Registered Bank Holding Companies, telephone conversation held on March 10, 1969.

[3] See *supra*, pp. 85-87.

Association of Corporate Owners of One Bank

On September 28, 1968, at a meeting in Chicago, Illinois, just before the annual convention of the American Bankers Association, some 200 one-bank holding company representatives formed the Association of Corporate Owners of One Bank and announced their opposition to any proposed regulatory legislation that would limit their acquisition goals to financially related enterprises. The strategy of the organization was outlined in a brief statement of policy. The statement announced that the purpose of the new organization was:

> . . . to demonstrate to legislators, the business community and other interested groups that we are serving the public interest by meeting market needs and competition. We recognize [it added] that the public interest requires both the protection of bank depositors and the fullest possible service to the public. We submit that existing legislation is fully adequate to achieve both.[1]

The Association has since modified its position and will support the Administration's proposal. It would, however, with respect to the delineation of the permissible activities in which banks and bank holding companies may engage, prefer majority rather than unanimous agreement by the proposed inter-agency council. It is unalterably opposed to the Patman and Proxmire measures, which, of course, if passed, would mean the break-up of its members' financially related, but not bank related, corporate structures. It would not support the Administration's bill if it were to require divestiture of

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[1] Association of Corporate Owners of One Bank, "General Platform," p. 1.

nonbanking enterprises currently held by existing or proposed one-bank holding company entities.[1]

Government Participation

Comptroller of the Currency

William B. Camp, the Comptroller of the Currency of the United States, consistently has carried on the innovative leadership instituted by his predecessor, James J. Saxon.[2] It was well documented earlier in this work that the Comptroller's office was in the vanguard of the movement by national banks to participate in a broader range of financial activities than previously deemed incidental to the business of banking.[3] As such, it is inconceivable that Mr. Camp would not support the Administration's recommended action. One thing is certain, he does not subscribe to the Patman or Proxmire bills, where jurisdiction over one-bank holding companies would be given to the Federal Reserve:

> . . . the effect would be to penalize many of those banks which have been most energetic in responding to the burgeoning needs of the public for expanded financial services. They would suffer not only an added layer of

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[1]Private interview held on February 18, 1969, with the Washington representative of a large bank corporation. (The contributor requested not to be publicly identified.) Obviously, the Association fears that the unanimous agreement provision places an unwelcome veto power in the hands of the Federal Reserve Board.

[2]Mr. Saxon has been described as a man who transformed an office and inspired an industry, a rare personality in government service. Cates, "Rush to One-Bank Holding Companies," p. 22.

[3]See supra, pp. 66-77, 111-12.

public controls, but they would be subjected to supervision under . . . an agency whose outlook and personnel--except of recent date--is principally concerned with matters of monetary policy.[1]

Federal Deposit Insurance Corporation

With respect to the regulatory control of one-bank holding companies, the chairman of the Federal Deposit Insurance Corporation, Kenneth A. Randall, has played a role of neither judge nor advocate, but of concerned observer. His public statements express a perceptive overview of the situation as it now exists:

> . . . Differing conclusions among the bank supervisory agencies have been due partly to differences in the precise language of the statutes and possibly in part to differences in the interpretation of statutory terms. Statutory differences can be removed by legislative action once the situation has been recognized and a decision made that the difference may not be desirable. What is most important is to recognize that a situation may need to be changed.[2]

> . . . I believe that banks should be oriented to supplying services to the nation of a nature that are consistent with and properly related to the business of banking, . . . [however] there is a need for flexibility of operations, in a dynamic economy, they will obviously change over time. . . . If a need for regulation is indicated [of one-bank holding companies], the emphasis should be on safeguards against self-dealing, anti-competitive effects, excessive concentration of economic power and changes to the banking institution and to the general public.[3]

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[1]William B. Camp, address delivered before the National Bank Division of the American Bankers Association 94th Annual Convention, Chicago, Ill., September 30, 1968.

[2]Kenneth A. Randall, chairman of the Federal Deposit Insurance Corporation, address delivered before the Graduate School of Banking, University of Wisconsin, Madison, Wisc., August 21, 1968.

[3]*Idem*, address delivered before the Baltimore Chapter of the American Marketing Association, Baltimore, Md., October 17, 1968.

In view of these sentiments and by virtue of an insight gained by a personal interview with Chairman Randall on February 12, 1969, the writer is convinced that the Chairman will support the Administration's proposed legislation. This does not mean that the Chairman is in accord with all the Administration's recommendations, but that the package is in the mainstream of his professional judgment.

Board of Governors of the
Federal Reserve System

The Federal Reserve, as mentioned earlier in this work, has consistently maintained that one-bank holding companies should be included within the purview of the Bank Holding Company Act.[1] Traditionally, the Board has pressed for stiff regulatory controls over these companies. A review of a statement issued on February 20, 1969, wherein the Board's current position concerning future amendments to the Bank Holding Company Act was set forth, however, indicates that it is in favor of some easing of restrictions on the entry of bank holding companies into nonbanking fields. The statement is the result of several months intensive study by the Board of the problems generated by the one-bank holding company development. Significant declarations contained therein include:

> . . . Consistent with continued growth and development of a dynamic and increasingly complex economy, banks should be granted greater freedom to innovate new services and procedures, either directly, or through affiliates in a holding company system, subject to administrative approval of entry and acquisitions to prevent activities inconsistent with the purposes of this act.

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[1]See supra, pp. 84, 88.

> Bank holding companies should be allowed to enter certain nonbanking areas of activity, specified in statute or agency regulation, which would facilitate broader services for the public. . . .
> The Board believes that it would be most effective for one agency (preferably the Board) to continue to administer the Bank Holding Company Act with respect to the holding companies themselves and with respect to the approval of acquisitions by holding companies. . . . the Board believes that the acquisition of subsidiaries by individual banks should be dispersed among the three bank regulatory agencies.
> . . . Other amendments to the Act also merit favorable action by Congress. . . . [amendments] to bring partnerships within the coverage of the Act; to broaden the Board's authority to determine that a company owns or controls a bank; . . . and to prohibit tie-in arrangements.[1]

In view of the foregoing statements, the Board is apparently in general agreement with the Administration that banks should be allowed additional latitude to meet their customers' constantly changing demands. This is a significant reversal of its prior restrictive interpretations of Section 4(c)(8) of the Bank Holding Company Act.

A further review of the Board's position statement, clearly indicates several areas where it is not in complete accord with the Administration's proposed legislation. The Board believes: (1) It would be "most effective" for the Board to pass on acquisitions by one-bank holding companies, but that acquisitions of subsidiaries by individual banks should be dispersed among the three bank regulatory agencies. (2) If the authority over bank holding companies must be divided among the three agencies, the Board should have jurisdiction over all

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[1]Board of Governors of the Federal Reserve System, "Statement of Principles with Respect to Amendments to the Bank Holding Company Act," Washington, D.C., Feb. 20, 1969, pp. 1-3, 5.

types of acquisitions by multi-bank holding companies and that the authority over nonbank activities of one-bank holding companies should be dispersed, with a requirement that the regulations should be jointly promulgated among the three agencies and would also be applicable to nonbank acquisitions by multi-bank holding companies. (3) One-bank holding companies in existence before the recent trend to their formation should be given a "qualified exemption."[1]

Obviously, the Board does not desire to lose its position as being the sole regulator under the Bank Holding Company Act, and, if other agencies are to be granted regulatory powers under the act, then it does not want to be deprived of its existing grant of authority to oversee the bank acquisitions and nonbank activities of multi-bank holding companies. The Board's alternative approach to the jurisdiction problem is not far removed from the Administration's solution.

It seems clear that the Board's position is somewhere between the Patman bill and the Administration's proposal.[2] The writer believes that the Board will not publicly endorse either measure but will present its views when called upon to

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[1] Ibid., pp. 3-4. (The Board suggested July 1, 1968, as the effective date of the "grandfather clause.")

[2] Board vice-chairman, J. L. Robertson, did not join in the Board's statement, but issued a separate one asserting that all but small one-bank holding companies should be brought under the act without any "grandfather clause," that some expansion of bank powers through subsidiary or holding companies is justified, but that it is "essential" that administration of the act "should be vested in one Federal agency to assure uniformity in its application." (Governor Robertson's statement was appended to the Board's "Statement of Principles" cited in n. 1, p. 131.)

testify at hearings to be held on this subject during the present session of Congress.

At this juncture, it would seem that Undersecretary Walker has achieved, if not a marriage, at least an engagement between the forces within the banking industry and the Government that have so vital an interest in the legislative resolution to the one-bank holding company problem. In the truest sense, it is a negotiated consensus. As such, it is highly vulnerable to the incisive scrutiny it will receive during the congressional deliberations to be held during the current session of the Congress over the proposed changes to the Bank Holding Company Act. Indeed, as one writer sees the situation:

> . . . Clearly, the administration's proposal hangs together by reason of a set of checks and balances. Dissatisfaction with one provision is offset by safeguards or advantages in another. This is a reflection of the intensive negotiations conducted during the past several weeks. It also suggests that if the plan ever begins to unravel at one corner during the legislative process, the entire fabric may fall apart.[1]

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[1]"One-Bank Holding Companies--End of the Road?" Golembe Associates, p. 3.

CHAPTER VI

SUMMARY AND CONCLUSION

It has been amply demonstrated that throughout its historical development, the American banking industry has been subjected to substantial state and/or federal regulatory controls. As stated in Chapter One, the specific research question to which this study is addressed is whether or not one-bank holding companies should be subjected to the regulatory jurisdiction of the federal government. The principal findings of this paper will be briefly summarized, followed by a presentation of the writer's views as to what changes in federal banking legislation should be enacted in order to best serve the public interests.

The banking industry in America is operative in a dual banking structure. That structure is subjected to public policy approaches which were formulated primarily for promoting the soundness of banks and, thereby, to provide for the safety of depositors' funds. The direction and extent of that policy has been developed primarily through reactionary responses to problems encountered in an atmosphere of crisis or under conditions of intense urgency.

By virtue of fears expressed by our policy-makers over possible undue concentrations of economic power and/or possible adverse effects on the solvency and liquidity of banks, a

major portion of banking legislation has been and is directed toward the separation of the business of banking from that which is not considered appropriate for banking. In a constantly changing economic environment, however, it is not feasible nor desirable to establish a uniform and constant definition of the term, "business of banking." In such an environment, progressive bank managers have been impelled by underlying economic forces to seek profitable investments in activities not traditionally considered incidental to the proper banking activities. The surging growth in the number and size of one-bank holding companies in recent years is attributed to competitive market forces, to conflicting interpretations of banking legislation and to the restrictive regulatory attitude of the Board of Governors of the Federal Reserve System, all of which have acted to place constraints on the desires of bank managements to more fully serve the financial needs of a progressive nation.

The statutory authority for the maintenance of a free and competitive banking environment is not lacking. By precedent action and future intent of the federal government, the applicability of the antitrust laws toward the prevention and/or correction of undue concentrations of economic power in banking, and the abuses thereof, has been firmly established. Implementation of public policy, however, is often more difficult than the processes by which that policy is formulated. If the antitrust laws are to prove a viable force acting to prevent undue concentrations of economic power by one-bank

holding companies, they must be vigorously enforced and zealously guarded against encroachment from the pressures inherent in the political process.

The adequacy of the powers available to the federal bank supervisory agencies to protect bank depositors from unsafe or unsound banking practices by the formation and operation of one-bank holding companies cannot be seriously questioned. They include the authority to examine a bank's records and the records of all affiliates and subsidiaries of the bank, irrespective of the corporate structure of the bank itself. Cease-and-desist powers under the Financial Supervisory Act together with the power to disenfranchise the bank of an affiliate that refuses to give a bank examiner pertinent information or to submit to examination are powerful tools in the hands of the regulatory agencies. One-bank holding companies, which by their very nature are dependent upon a viable banking subsidiary, will not antagonize the regulatory agencies by such refusals or by engaging in activities which would be considered inconsistent with the competitive posture and solvency of the bank which it controls.

Under the present body of banking law and the administrative interpretations thereof, the public that is served by banks which are under the regulatory jurisdiction of the Board of Governors of the Federal Reserve System are not free to enjoy many of the peripheral banking services offered by the managements of the newly created financial congenerics. Consequently, a severe inequity is being endured by the

operators of registered bank holding companies. It is unconscionable to allow this inequity to persist.

Legislative proposals for the purpose of extending federal regulatory controls over the activities of one-bank holding companies have been introduced by Senator Proxmire, Congressman Patman and the Administration. In the sense that all three proposals espouse federal regulation over the activities of the financial congenerics, they are reflective of the traditional reactionary responses to changing conditions in the banking environment. The Administration's proposal, however, is the only one which recognizes the requirement for a more liberal legislative position apropos the diversification needs of the banking industry.

The public interest would not be best served by hasty legislation enacted to halt a movement toward increased competition in the financial markets. There is no real need for new legislation designed to frustrate, limit, or control the formation or activities of one-bank holding companies. The antitrust powers of the Federal Government, properly administered and aggressively enforced, are adequate to prevent undue concentration of power in any sphere of economic activity in this progressive nation.

The banking industry should be allowed to test the soundness of the one-bank holding company concept (full-line financial services) in the market place. Where their efforts are proven successful, it can only mean that there was a need for additional competition. The public would ultimately gain.

The writer is in agreement with the advocates of the one-bank holding company movement who contend that these organizations will confine themselves largely to the financial area,

> . . . not because of any special set of laws but because banks are not managed by supermen. Attempts to compete in areas where bank expertise . . . [is] not an advantage would . . . [be] rebuffed by the inexorable laws of competition. To believe otherwise is to believe that for some 150 years banks were capable of taking over the economy through bank holding companies but, for some reason did not become aware of this possibility until 1968.[1]

In order to allow full parity of opportunity by the multi-bank holding companies, the individual banks,[2] and the one-bank holding companies to compete in the market, existing legislation should be amended to grant registered bank holding companies and individual banks the same flexibility to acquire, establish, and operate affiliates that one-bank holding companies presently enjoy.

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[1]"One-Bank Holding Companies--End of the Road?" Golembe Associates, p. 9.

[2]As noted in the previous chapter, the Administration's proposal provides full parity for all segments of the banking industry. By virtue of requiring one-bank holding companies to register under the Bank Holding Company Act as presently written, and since they make no reference to parity treatment for individual banks, the Patman and Proxmire bills would achieve parity only between bank holding companies. The passage of either of these measures in their present form would be strong motivation for the financial congenerics to revert to a nonholding company corporate structure in order to avoid subordination to the Federal Reserve Board's restrictive interpretations of what constitutes proper banking activities. These managements would also be motivated to test the effectiveness of the "incidental powers clause" to prevent their engagement in full-line financial services activities.

The writer is convinced that the American economic environment should be one that encourages innovative, resourceful, and adaptive change rather than frustrating it. Banking is an integral part of that environment. If the banking industry is to continue to fulfill its responsibility for financial stewardship of the economy, the restrictive strait jacket imposed on the industry by existing banking legislation must be loosened to correct the unequal competitive position that banks have with other profit-centered companies providing financial services to the public.

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